TRUSTS AND TAX GENERAL ANTI-AVOIDANCE RULES

Does the new GAAR prevent selected common structured transactions involving the interposition of a trust?

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DECLARATION

Research dissertation presented for the approval of Senate in partial fulfilment of the requirements for the Master of Commerce in Taxation by coursework and dissertation.

I hereby declare that I have read and understood the regulations governing the submission of Master of Commerce in Taxation dissertations, including those relating to length and plagiarism, as contained in the rules of this University, and that this dissertation conforms to those regulations.

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ABSTRACT

General anti avoidance provisions ("GAAR") in the Income Tax Act and the accompanying judicial doctrines have been developed to combat schemes that are designed primarily to avoid the incidence of taxation by exploiting the loopholes in the Act. On the other hand, trusts in South Africa have commonly been used as a means to warehouse and freeze assets in order to minimise estate duty and also in schemes designed to minimise or escape income tax and donations tax.

In South Africa the GAAR provisions (sections 80A to 80L) are fairly new and there is no case law yet to provide guidance on the depth and its scope of application. This dissertation seeks to analyse the impact that the new provisions of the general anti avoidance rules and the so-called judicial doctrines have on transactions or schemes involving a trust. It will also try to answer whether the previous general anti avoidance rules (section 103(1)) was effective against these schemes/transactions and, if not, whether the new provisions are effective against previously successful schemes/transactions.

In that perspective, chapter one provides an introduction and the research methodology adopted to provide a possible answer to the research question. Chapter two introduces the concept of trusts in South Africa, the types and classes of trust available in the legal system and the different components and parties to a trust. Chapter three will be focused on a discussion of both the old and the new GAAR and includes a comparison of the provisions to analyse the possible impact on the selected structured transactions. In chapter four, the common tax tools involving trusts will be introduced in the form of examples and the tax benefit resulting will be discussed and analysed and then applied against both the old and new provisions. Chapter five provides the conclusions reached and proposed recommendations to prospective/current founders and trustees.

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ABBREVIATIONS

AD	Appellate Division
CGT	Capital Gains Tax
CIR	Commissioner for Inland Revenue
CSARS	Commissioner for the South African Revenue Service
EDA	Estate Duty Act No.45 of 1955
GAAR	General Anti Avoidance Rules
ITA	Income Tax Act No.58 of 1962
ITC	Income Tax Court
PN	Practice Note
S	Section
SAIT	South African Institute of Tax Practitioners
SARS	South African Revenue Service
SATC	South African Tax Court
SCA	Supreme Court of Appeal
SIR	Secretary of Inland Revenue
STC	Secondary Tax on Companies
STT	Securities Transfer Tax

STTA	Securities Transfer Tax Act No. 25 of 2007
TDA	Transfer Duty Act No. 40 of 1949
UK	United Kingdom

CHAPTER 1

Introduction and Research Methodology

1.1 Introduction

Trusts are regularly used as tax planning tools to enable taxpayers to minimise or, at times, avoid tax liabilities. This dissertation seeks to analyse selected transactions involving the interposition of a trust and whether or not the new GAAR renders such structured transactions obsolete.

1.2 Aims and Objectives

The primary objective is to analyse the impact the new GAAR has on trusts created as part of a tax plan (for example, an estate plan). The secondary objective is to discuss the concept of tax avoidance and the rights of taxpayers to arrange their affairs so as to attract less tax.[1]

This dissertation aims to:

- Analyse the common structured transactions involving the interposition of a trust and the tax savings benefit and or tax avoidance that such transactions provide;
- Through discussion and comparison, analyse the old and new GAAR and the requirements for successful application (Chapter 3);
- Test the selected tax structured transactions against the requirements for successful application of the old and new GAAR (Chapter 4).

[1] *Erf 3183/1 Ladysmith (Pty) Ltd and another v CIR*, 58 SATC 229 (A):236; Lord Tomlin in *IRC v Duke of Westminster* [1936] AC 1 at 19; Shell Canada Ltd. v. Canada, [1999] 3 S.C.R. 622, Para 45; *CSARS v LG Electronics* (428/09) [2010] ZASCA 79 (28 May 2010), Para 25; *CSARS v NWK* (27/10) [2010] ZASCA 168 (1 December 2010), Para 42

1.3 Research Methodology

This dissertation follows a doctrinal research methodology. McKerchar (2008: 18-19) states that "Doctrinal research is […] typified by the systematic process of identifying, analysing, organising and synthesising statutes, judicial decisions and commentary". In this context, the legislation, judicial decisions and commentary from South Africa, Canada, Australia and the United Kingdom concerning GAAR are analysed (Chapter 3) to provide the basis against which the analysis of the tax planning tools may be conducted (Chapter 4). The choice of Canada, Australia and the United Kingdom as additional sources is justified as the South African Legislature and the South African courts have drawn on legislation and case law from each of these jurisdictions in the past.

1.4 Limitations

This dissertation is limited to the consideration of transactions involving the interposition of South African trusts where all persons engaged in the transaction are residents. Non-South African trusts or non-South African parties to the transactions are not addressed. Many of the principles applied to these transactions may, however, extend to such non-South African trusts. It should be noted that non-South African trusts would require the consideration of additional sections of the ITA and their application, for example S7(8), S25B(2) of the ITA. In addition, the possible applications of DTAs are not considered. All connected persons[2] to the trusts in the scenarios considered are also assumed to be residents[3] in the Republic.

[2] S 1 of the ITA

[3] Ibid

1.5 Structure of the dissertation

The study is divided into five chapters including this introductory chapter. Chapter 2 provides the background to the concept of trusts in South Africa and the different types of trusts available. It is in this context that the interposition of the trust is considered.

Chapter 3 provides the analysis of the old GAAR (section 103(1)) and the new GAAR (sections 80A to 80L) of the ITA in order to identify the main requirements for a successful application of these anti-avoidance provisions. In addition, the chapter considers the application of the judicial doctrines of substance versus legal form in the context of the application of GAAR. Since no precedents from our courts are available on the interpretation of the new GAAR, the general rules applicable to the interpretation of fiscal legislation are applied to these new GAAR provisions using foreign precedents for additional guidance as to its interpretation.

Chapter 4 contains the key test of structured transactions against the old and new GAAR. This chapter is presented in the form of scenario analysis (by example) to provide context to the structured transaction being analysed. The tax implications, savings and / or avoidance that arise through the application of such transactions will be outlined and these transactions will then be tested against both the old and new GAAR.

Chapter 5 contains the conclusions and recommendations that will help the taxpayer in avoiding successful application of GAAR as contained in the ITA.

CHAPTER 2

A brief introduction to the concept of trust in South Africa

2.1 Introduction and the history of trusts in South Africa

This chapter will outline the "trust" concept in South Africa. A discussion of the types and classes of trust is also considered.

The English trust found its way to South Africa when the Cape became a British colony and at the time Roman Dutch law remained the official legal system as part of a treaty.[4] In common law, a trust is neither a legal person nor a juristic person and therefore does not enjoy a separate legal persona.[5] It is deemed to be a separate legal person for the purpose of some statutes only, e.g. the ITA and the Value Added Tax Act 89 of 1991 amongst others. S1 of the ITA states that for the purpose of the Act a trust:

> "means any trust fund consisting of cash or other assets which are administered and controlled by a person acting in a fiduciary capacity, where such person is appointed under a deed of trust or by agreement or under the will of a deceased person".

The definition of person in the ITA was only amended in 1992 to include a trust, following the decision in the case of *CIR v Friedman & others NNO*[6] where it was held that a trust was not a "legal persona" and therefore not a "person" within the meaning of that word in the ITA and accordingly the Commissioner was not entitled (at that time) to levy taxation on the trust in terms of the ITA.

[4] WM Van der Westhuizen, 2009, Wills and Trusts, Butterworths, B1-B2, p4

[5] *Yarran Trading CC t/a Tijuana Spur v Absa Bank Ltd* 2007 2 SA 570 (SCA), Pg576H, WM Van der Westhuizen, 2009, Wills and Trusts, Butterworths, B1-B2, p4

[6] 1993 (1) SA 353 (A) and also *Trustees of the Phillip Frame Will Trust v CIR* 53 SATC 166, 1991 (2) SA 340(W).

2.2 Classes of trusts

Trusts can be divided into two main groups:

Inter vivos trust. *Inter vivos* being a Latin word which means "among the living" referring to its creation during the life of the founder. This type of trust can extend beyond the founder's life.

A testamentary trust, or trust *mortis causa*, will only apply with the death of the founder and is created by the last will and testament of the testator. It is worth to note that a testamentary trust has limited use as part of a tax tool in an estate planning. This is due to the fact at the time of death, the testator still owns all his assets and thus in terms of Paragraph 40 of the Eighth Schedule to the ITA, will deemed to have disposed of all these assets (save from exemptions listed in subparagraph (a) to (d)) and will thus be liable to CGT. These assets will also form part of his estate by virtue of S 3(2) of the EDA and will thus be subject to estate duty. However, a testamentary trust may benefit the heir(s) of the deceased person, as the assets bequeathed to the trust, will not form part of their estate unless there is a vesting of trust assets to the beneficiaries.

2.3 Types of trust

A trust can either be a discretionary or vesting trust.

2.3.1 Discretionary trust

In a discretionary trust, ownership and management of the trust's assets are vested in the trustees but they have no interest in those assets.[7] The beneficiaries also hold no rights over the assets of the trusts; they hold a mere *spes* (hope). The beneficiaries only have right to

[7] *Estate Kemp v McDonald's Trustee* 1915 AD 491; *SIR v Rosen* 1971 1 SA 172 (A)

claim income and/or capital that are due to them once it has been vested by the trustees to the beneficiaries.

The extent of the discretionary powers that vest in the trustees is determined in the trust deed. It is submitted that a trust can also be partly discretionary, where part of the trust capital and /or income is subject to the trustee's discretionary power and the other is vested in the beneficiaries.

The trust deed may also empower the trustees to make distributions in unequal shares to the beneficiaries or even exclude certain beneficiaries from any distribution. The Trustees may also be empowered by the trust deed to appoint further beneficiaries or remove existing beneficiaries.[8] An important feature of a discretionary trust is that the growth in assets owned by the trust prior to death of the founder is not added to his/her assets for estate duty purposes.

2.3.2 Vested trusts

In a vested trust, the ownership of the trust's assets is vested in the beneficiaries and the trustees only have control and the management of those assets. In the case of *Jewish Colonial Trust Ltd v Estate Nathan*[9] Watermeyer CJ described that *"the word vest is used to draw a distinction between what is certain and what is conditional"* and in another case of *Durban City Council v Association of Building Societies,*[10] the same judge described that *"the word contingent as opposed to vested is used to describe the conditional nature of someone's title to the right."*

[8] Davis et al, Estate Planning, LexisNexis, Pg 5-14

[9] 1940 AD 163, p 175

[10] 1942 AD 27, p 33

Therefore if a beneficiary has a vested right in a trust capital or income, this will form part of his assets for the computation of capital gains tax on death of the beneficiary and also part of his estate for estate duty purposes. In a vested trust, the ownership of the trust's assets is vested in the beneficiaries and the trustees only have control over the management of those assets. The trustees have no discretion as to distributions. They must distribute or accrue the net income and/or trust capital in terms of the trust deed. These types of trusts do not offer as many financial planning opportunities as discretionary trusts and they are more often set up for reasons other than taxation.

2.3.3 Special Trusts

The concept of special trust[11] was introduced by the legislature for income tax purposes only and is defined in Section 1 of the ITA, it consists of two categories. On the other hand, for the purpose of the Eighth Schedule of the ITA, a special trust would mean only category (a) of the definition of the special trust as listed in S 1 of the ITA.

[11] means a trust created-

a) solely for the benefit of a person who suffers from—

   i) any 'mental illness' as defined in section 1 of the Mental Health Care Act, 2002 (Act No. 17 of 2002); or

   ii) any serious physical disability,

   where such illness or disability incapacitates such person from earning sufficient income for the maintenance of such person, or from managing his or her own financial affairs: Provided that where the person for whose benefit the trust was so created dies, such trust shall be deemed not to be a special trust in respect of years of assessment ending on or after the date of such person's death;

b) by or in terms of the will of a deceased person, solely for the benefit of beneficiaries who are relatives in relation to that deceased person and who are alive on the date of death of that deceased person (including any beneficiary who has been conceived but not yet born on that date), where the youngest of those beneficiaries is on the last day of the year of assessment of that trust under the age of 21 years;

These types of trusts enjoy a number of benefits, for example taxation at the marginal rates applicable to natural persons. However, by virtue of Section 6 of the ITA such trusts are not entitled to a primary rebate. In addition, these trusts are not entitled to the basic interest exemption applicable to natural persons by virtue of Section 10(1)(i)(xv) of the ITA.

Another benefit of a special trust as listed in Para (a) of S 1, is that qualifies for an inclusion rate of 25% for Capital Gains Tax purposes and Primary Residence exclusion in terms of Para 44 of the Eighth Schedule to the ITA. This trust is also entitled to hold personal use assets which are excluded from any Capital Gains consequences by virtue of Para 53 of the same Schedule.

It is clear that these types of trusts are not meant to be used as tax planning tools as they have very restrictive use. They are meant to be used for specific circumstances, to protect the interest of minors and persons with disabilities.

2.4 The use of trusts

The concept of trusts has been widely used in South Africa as a tool in estate planning, with a view to minimise estate duty payable at the death of a natural person. It can protect the personal assets of a natural person by providing a hedge against creditors in the event that person becomes insolvent. A trust can also be used as a tool in the protection of family assets in the event of dissolution of marriage by preventing any redistribution of assets which has been purchased or inherited during the lifetime of one marriage. A trust can be ideal to deal with problems of dividing a single immovable property in the sense that it acts as a vehicle for the joint ownership of an immovable property. A trust can also be used in a situation, where a family member is either mentally incapacitated or has a serious physical disability. Parents of such persons often use trusts to ensure the maintenance and well being of that person after their death.

2.5 The office of Trustees

The office of trustees is governed by the Trust Property Control Act.[12] Critical to the concept of trusts is that the founder/donor may not be the sole trustee and the sole beneficiary.[13] This view was also supported by Cameron JA in the case of *Land & Agricultural Bank of South Africa v Parker & others*.[14]

2.5.1 Definition of Trustee

The definition is trustee is defined in Section 1 of the ITA as:

> "in addition to every person appointed or constituted as such by act of parties, by will, by order or declaration of court or by operation of law, includes an executor or administrator, tutor or curator, and any person having the administration or control of any property subject to a trust, usufruct, fideicommissum or other limited interest or acting in any fiduciary capacity or having, either in a private or in an official capacity, the possession, direction, control or management of any property of any person under legal disability".

The term trustee is also defined in Section 1 of the Trust Property Control Act[15] as:

> "means any person (including the founder of a trust) who acts as trustee by virtue of an authorization under section 6 and includes any person whose appointment as trustee is already of force and effect at the commencement of this Act".

[12] Act 57 of 1988

[13] *Goodricke v Registrar of Deeds, Natal* 1974 (1) SA 404 (N), Pg 408, *Nel & Others vs Metequity Ltd & Another* 2007 (3) SA 34 (SCA) 37

[14] 2005 (2) SA 77 (SCA), [2004], Para 19

[15] Trust Property Control Act 57 of 1988

The trustee can be any person who has the capacity to act as a trustee. The trustee owes fiduciary duty to the trust and his private affairs should be completely separate from the trust and thus avoid conflicts of interest at all times. In the *Land and Agricultural Bank of South Africa v Parker*,[16] Cameron JA described an example of a "proper" trustee as follows:

> "but someone who with proper realisation of the responsibilities of trusteeship accepts office in order to ensure that the trust functions properly, that the provisions of the trust deed are observed, and that the conduct of trustees who lack a sufficiently independent interest in the observance of substantive and procedural requirements arising from the trust deed can be scrutinised and checked".

2.5.2 Appointment of Trustees

The appointment of a trustee can be made by the founder of the trust, by other trustees currently in office, by the beneficiaries, by a court order or by the Master of the High Court. The person to be appointed as a trustee must give their consent to act as trustee in writing. Thereafter the Master must issue a written authorisation *(letter of authority)* to the trustee, before that person can act in that capacity.[17] In the absence of the letter of authority, any person nominated to act as trustee cannot officially take the office of trustee.[18]

In the event that the number of trustees falls below the minimum number of trustees as provided by the trust deed, the other trustees must appoint another trustee, to comply with

[16] 2005 2 SA 77 (SCA), Para 36

[17] Trust Property Control Act 57 of 1988 s 7(1)

[18] Trust Property Control Act 57 of 1988 s 6(1); *Simplex (Pty) Ltd v Van der Merwe*, 1996 (1) SA 111 (W), p 112

the requirement of the trust deed.[19] If the vacant trustee office cannot be filled then the Master of the High Court may appoint any person as a trustee.[20] As long as the number of trustees is below the minimum as required by the trust deed, the remaining trustees have no authority to bind the trust and any contract or agreement entered by the trust during that period shall be null and void.[21]

The office of trustee is governed by the Trust Property Control Act 57 of 1988. In terms of this Act, the Master of the High court is empowered to insist on the appointment of independent outsiders as trustees, to prevent and restrict the misuse and abuse of trusts.[22] This view was observed in the case of *Land and Agricultural Bank of South Africa v Parker*,[23] Cameron JA observed the following:

> "The debasement of the trust form evidenced in this and other cases, and the consequent breaches of trust this entails, suggest that the Master should in carrying out his statutory functions ensure that an adequate separation of control from enjoyment is maintained in every trust. This can be achieved by insisting on the appointment of an independent outsider as trustee to every trust in which (a) the trustees are all beneficiaries and (b) the beneficiaries are all related to one another".

The independent trustee must be able to act as such. The consequences of a trustee treating trust assets as his own and using an independent trustee merely as a "rubber stamp" was outlined in the case of *CSARS v Airworld cc and Another*.[24]

[19] *Land and Agricultural Bank of South Africa v Parker*, 2005 (2) SA 77 (SCA)

[20] Trust Property Control Act 57 of 1988 s 7(1)

[21] *Land and Agricultural Bank of South Africa v Parker*, 2005 (2) SA 77 (SCA)

[22] Trust Property Control Act 57 of 1988 s 7(2)

[23] 2005 2 SA 77 (SCA), Para 35

[24] 2007 SCA, 70 SATC 48

2.5.3 Powers and duties of Trustees

The powers enjoyed by the trustees will entirely depend on the provisions of the trust deed; however, the trustees shall not exceed their powers nor act outside the provisions of the trust deed.[25]

Trustees have the duty to act jointly, unless specified otherwise in the Trust deed and failure to do so in contracting an agreement to bind the trust may be null and void.[26] However, in the case of *Man Truck & Bus (SA) Ltd v Victor en Andere*,[27] it was held that where a trustee had bound the trust to a suretyship agreement, without the consent of the other trustees, the agreement remained binding on the trust by virtue of the application of the Turquand Rule.[28] This would appear to be the exception to the rule as evidenced in the case of *Thorpe v Trittenwein*[29] where the court found that in the absence of a joint decision, the assent of a single trustee to a contract did not bind the trust.

Trustees are required to exercise due care and diligence and use reasonable judgement in the best interest of the trust[30] and any indemnity clause in the trust deed attempting to indemnify the trustee against personal liability for breach of trust is null and void.[31]

[25] *Land and Agricultural Bank of South Africa v Parker*, 2005 (2) SA 77 (SCA)

[26] *Niewoudt & Another NNO V Vrystaat Mielies (Edms) Bpk* 2004 (3) SA 486 (SCA)

[27] 2001 (2) SA 562 (NC)

[28] *Royal British Bank v Turquand* (1856) 6 E&B 327 is a UK company law case that held people transacting with companies are entitled to assume that internal company rules are complied with, even if they are not. This "indoor management rule" or the "Rule in Turquand's Case" is applicable in most of the common law world. It originally mitigated the harshness of the constructive notice doctrine.

[29] 2006 SCA 30 (SCA)

[30] *PPWAWU National Provident Fund v CEPPWAWU* 2008 (2) SA 351 (WLD)

[31] Trust Property Control Act 57 of 1988, s 9(2)

A trustee is entitled to be remunerated for his services rendered to the trust; the trust deed may provide for the quantum and the conditions for payment. In absence of any provisions in the trust deed or a dispute, the Master of the High Court may fix the remuneration.[32]

2.6 Beneficiaries

The essence of the formation of a trust is that the trust's income and capital must be controlled by the trustees for the benefits of the beneficiaries. The ITA defines a beneficiary as follows:

> "in relation to a trust means a person who has a vested or contingent interest in all or a portion of the receipts or accruals or the assets of that trust."

2.6.1 Rights of beneficiaries

There may also be different classes of beneficiaries with different rights. For example, certain beneficiaries might have a vested or a discretionary interest in the trust. The said interest may further be specific, either capital or income or both. In a *bewind* trust, the beneficiaries have vested rights in the trust income and capital.

The rights the beneficiaries enjoy will be determined by the provisions of the trust deed or it can be left to the discretion of trustees in the case of discretionary trusts.

2.7 Conclusion

Although there are several types and classes of trust available in the South African legal system, one must choose a type and class of trust that will best suit his/her needs while also taking into consideration the financial flexibilities and taxation implications each kind of

[32] Trust Property Control Act 57 of 1988, s 22

trusts provide. The administration of the trust is also an important component; when a trust is conceptualised, the founder(s) and the trustees are bound to adhere to the provisions of the trust deed and also to its statutory requirements, as any departures therefrom may result that a competent court to declare the trust as a ‘sham trust’.

CHAPTER 3

A discussion and comparison between the new and old GAAR

3.1 Background and introduction to the new GAAR

The new GAAR, namely Part IIA of the ITA (sections 80A to 80L), has been effective as from 2 November 2006, replacing the old GAAR, namely sections 103(1), (3), and (7). It is submitted that GAAR's purpose is to draw the line between legitimate tax minimisation and abusive tax avoidance.[33]

Part IIA of the ITA will also apply in a situation where the primary purpose is to avoid taxes (other than those covered in the ITA) but has also resulted in an avoidance of taxes administered under the ITA[34] (a secondary purpose), since the term "tax" includes any tax, levy or duty imposed by the ITA or any other Act[35] administered by the Commissioner.[36] It would seem that this concept has found its way in the ITA, from the judgement emanating from *SIR v Gallagher*,[37] whereby the Commissioner had invoked section 103(1) of the ITA against the taxpayer on a scheme involving avoidance of estate duty. On the facts of this case, the taxpayer had successfully argued that his sole and main purpose of

[33] *Canada Trustco Mortgage Company v Canada* 2005 SCC 54

[34] Examples of taxes administered under the ITA are: Income Tax, Donations Tax, CGT

[35] Examples of such "other Acts" are: Value Added Tax Act No. 89 of 1991, Estate Duty Act No. 45 of 1955, Transfer Duty Act No. 40 of 1949, etc.

[36] The concept of linking GAAR to other Acts administered by CSARS is not new, S80L merely rephrase the old S103(7) which stated that:

> "a tax benefit would incorporate 'any avoidance, postponement or reduction of liability for payment of any tax, duty or levy imposed by this Act or by any other law administered by the Commissioner."

[37] *SIR v Gallagher* 1978 (2) SA 463 (A)

the creation of three trusts was to minimise estate duty and the income tax benefit obtained was merely a welcomed by-product and thus S 103(1) was inapplicable.

One of the most popular uses of trusts remains for estate planning, which has the purpose of minimising or avoiding estate duty.[38] This is normally achieved by the transfer of growth assets from the founder/donor to the trust and hence the capital appreciation of the assets occurs in the trust rather than in the hands of the individual (the founder of the trust). At the date of death of the natural person, the latter must hold the minimum assets possible. In terms of S 2 of the EDA, assets of the trusts not held by the deceased immediately prior to his death are excluded from estate duty. The later chapters will demonstrate that it is not only the avoidance of estate duty that is considered by taxpayers, but the minimisation of all taxes[39] (i.e. the structure that yields the maximum advantage).

The question to be answered in this dissertation is whether or not this type of structure or any part thereof could fall within the ambit of Part IIA of the ITA. Should it not fall within the ambit of Part IIA, it would remain an efficient tax planning scheme.

To assist in the analysis, the new and the old GAAR will both be applied to selected trust schemes. Schemes which escaped application in terms of the old GAAR are particularly relevant to test whether or not these schemes remain free from the scope of the new GAAR and thus are still efficient tax planning tools under the new provisions of the ITA.[40]

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[38] Huxham, K & Haupt, P "Notes on South African Income Tax – 2009", p. 700

[39] Income Tax, Donations Tax, CGT

[40] Lord Tomlin in *IRC v Duke of Westminster* [1936] AC 1 at 19; *Shell Canada Ltd. v. Canada*, [1999] 3 S.C.R. 622, Para 45

The objective of this dissertation is to attempt to address the above problem, as to define the boundaries and limitations of the new GAAR and the extent a taxpayer is entitled to minimise its tax burden using a trust as a mechanism.

Following Lord Tomlin's *obiter* in the *IRC v Duke of Westminster* case, the same views were also shared in other cases, such as in *Levene v IRC*,[41] where Lord Viscount Summer held that:

> "It is trite law that His Majesty's subjects are free, if they can, to make their own arrangements so that their cases may fall outside the scope of the taxing Act. They incur no legal penalties, and they strictly speaking, no moral censure if having considered the lines drawn by the legislature for the imposition of taxes, they make it their business to walk outside them".

However, Lord's Tomlin's decision in the oft-cited case *IRC v Duke of Westminster*[42] should not also be taken at face value and be applied in all tax avoidance/minimisation transaction. This is a decision from 1936 and the world economy has since drastically changed and the House of Lords in England have also made several adverse comments on this case.

In the case of *IRC v Burmah Oil Co. Ltd*,[43] Lord Diplock held that Lord Tomlin's remark says nothing as to what methods of ordering one's affairs will be recognised by the courts as effective to lessen the tax that would otherwise attach to them if business transactions were conducted in a straightforward way. In the case of *IRC v McGuckian*,[44] Lord Steyn, made the following remarks:

[41] [1928] AC 21; This decision is supported by Lord Clyde in the case of *Ayrshire Pullman Motors Services and DM Ritchie v IRC* 14 TC 754

[42] Lord Tomlin in *IRC v Duke of Westminster* [1936] AC 1 at 19

[43] [1982] STC 30 (HL) at 32

[44] [1997] 3 All ER 817 (HL)

> "While Lord Tomlin's observation in the Duke of Westminster case still points to a material consideration, namely the general liberty of the citizen to arrange his financial affairs as he thinks fit, they have ceased to be canonical as to the consequences of tax avoidance schemes".

Some of the main reasons advanced by the National Treasury, in their discussion paper dated 3 November 2005, for the enactment of the new GAAR, are as follows:

(1) There had been a growing number of complex and sophisticated tax schemes especially from the corporate taxpayers and growing numbers of tax avoidance products from professional firms;[45]

(2) Short term revenue loss for the fiscus thus weakening the ability of the Government to set and implement economic policies;

(3) The old GAAR was becoming obsolete with technological change, globalisation, de-regulation in financial markets and was also no longer in line with international standards.

It is unclear as to which "international standards" the Treasury referred, however critics on the matter state that this contention can be misleading as advanced countries have refrained from introducing such legislation and still prefer to rely on judicial general anti-avoidance doctrines.[46]

3.2 The requirements for application of the new GAAR

In the new GAAR much emphasis is placed on an "impermissible avoidance arrangement",[47] the provisions of Part IIA of the ITA are interlinked to define its scope and application. The main criteria of an impermissible tax arrangement can be broken, as follows:

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[45] SOUTH AFRICA. National Treasury Department, 2006, *Explanatory Memorandum on the Revenue Laws Amendment Bill 2006*, Government Printer. P 62

[46] Adv E Broomberg, SAFA seminar, *The New General Anti-Avoidance Rule*, p. 1

[47] S 80A of the ITA

1. There should be the presence of an avoidance arrangement;[48]
2. The avoidance arrangement or steps therein must result in a tax benefit;[49]
3. The sole or main purpose of the arrangement in issue was to obtain the tax benefit and also any one of the following must be present simultaneously;
4. The abnormality test;[50]
5. Any one of the tainted element tests as listed hereunder:
    5.1 The commercial substance test assessed on business risk and net cash flows;[51]
    5.2 The creation of non-arm's length rights and obligations test;[52]
    5.3 Whether the avoidance arrangement will result in the misuse or abuse of the ITA;[53]
6. The commercial substance test in 5.1 above contains a list of non-exhaustive indicators as listed hereunder:[54]
    6.1 The substance versus form doctrine;[55]
    6.2 The presence of round trip financing;[56]
    6.3 An accommodating or tax indifferent party;[57]
    6.4 Elements that have the effect of offsetting or cancelling each other;[58]

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[48] S 80 L of the ITA; The term 'transaction, operation or scheme' as contained in the definition of 'arrangement' was interpreted by Beyers JA in the case of *Meyerowitz v CIR*, 1963 (3) SA863 (A), 25 SATC 287

[49] S80T of the ITA; *Canada Trust Co Mortgage Company*, 2005 SCC 54, Para 21

[50] S 80 A (a) (i) of the ITA

[51] S 80 A (a) (ii), S80 C of the ITA

[52] S 80 A (c) (i)

[53] S 80 A (c) (ii)

[54] S 80 C of the ITA

[55] S80 C (2) (a) of the ITA; *Erf 3183/1 Ladysmith (Pty) Ltd and Another v CIR*, 1996 (3) SA 942 (A), 58 SATC 229; *CCE v Randles Bros & Hudson Ltd*, 1941 AD 369, 33 SATC 48

[56] S 80 C (2) (b) (i) and S80D of the ITA

[57] S 80 C (2) (b) (ii) and S 80 E of the ITA

6.5 The connected persons[59] test.[60]

The new GAAR was drawn largely from S 245 of the Canadian Income Tax Act. The Canadian courts have applied their GAAR cautiously and conservatively, as demonstrated hereunder.[61]

In the *Jabs Construction* case,[62] Associate Chief Justice Bowman of the Tax Court referred to the GAAR as follows:

"Section 245 is an extreme sanction. It should not be used routinely every time the Minister gets upset just because a taxpayer structures a transaction in a tax effective way, or does not structure it in a way that maximizes the tax".

In the *Canada Trustco* case,[63] Justice Miller warned that:

"GAAR is not to be imposed lightly. . . .[T]his is tax legislation to be applied with utmost caution".

In the *Fredette* case,[64] Justice Archambault wrote:

"Section 245 is a powerful tool for discouraging and preventing flagrant abuses of the Act. It cannot serve as a tool for the Minister to force taxpayers to structure their transactions in the manner most favourable to the tax authorities".

In *Geransky*,[65] Associate Chief Justice Bowman wrote:

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[58] S 80 C (2) (b) (iii), *Furniss v Dawson*, [1984] AC 474 HL

[59] S 1 of the ITA

[60] S80 F of the ITA

[61] Brian J Arnold, 2004, The long, slow, steady demise of the General Anti Avoidance Rule, *Canadian Tax Journal*, 52 (2): 490-491

[62] *Jabs Construction Ltd. v. The Queen*, [1999] 3 CTC 2556, Para 48

[63] *Canada Trustco Mortgage Co. v. The Queen*, [2003] 4 CTC 2009, Para 77

[64] *Fredette v. The Queen*, [2001] 3 CTC 2468, Para 76

[65] *Geransky v. The Queen*, [2001] 2 CTC 2147, Para 42 -43

"The *Income Tax Act* is a statute that is remarkable for its specificity and replete with anti-avoidance provisions designed to counteract specific perceived abuses. Where a taxpayer applies those provisions and manages to avoid the pitfalls the Minister cannot say: 'Because you have avoided the shoals and traps of the *Act* and have not carried out your commercial transaction in a manner that maximizes your tax, I will use GAAR to fill in any gaps not covered by the multitude of specific anti-avoidance provisions.' That is not what GAAR is all about".

The provisions of Part IIA of the ITA are new in South Africa and contain terms imported into the legislation. Their meaning has not been tested in the South African courts. However, the above foreign decisions may be persuasive and/or serve as guidelines on the course that may be followed in South Africa.

3.3 Tax consequences in a successful application of GAAR

Tax avoidance is not considered to be illegal; it is merely the manner in which a taxpayer exploits the provisions of the Acts to his advantage and thus arranges his affairs accordingly, so as to attract less tax than would normally be imposed. S 80B empowers the Commissioner to disregard a whole arrangement, reallocate income or expenditure, as though the transactions had never occurred.

3.4 The burden of proof

The burden of proof is generally governed by S 82 of the ITA, which places the onus on the taxpayer to prove to the CSARS, that any amount is not liable to tax. In the case of *Conhage*,[66] under the old S 103(1), the SCA held that the onus rested on the CSARS to prove that the effect of a "transaction, operation or scheme" was to avoid or postpone the

[66] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA)

liability for tax or to reduce the amount thereof.[67] Consequently S 82 could not be applied to S 103(1) of the ITA.

Once CSARS had proved that a tax benefit arises, the onus of proof shifted to the taxpayer to prove that the arrangement does not fall within the ambit of S 103(1).

In the new GAAR, a similar approach would seem to be adopted in the sense that the CSARS bears the onus to prove, on a balance of probabilities, that a 'tax benefit' was derived as a result of an arrangement being entered into.[68] However, in addition to S 82 of the ITA, the presumption of purpose test as provided in S 80G of the ITA will then shift this onus to the taxpayer. The preamble of this provision indicates that once CSARS has established an avoidance transaction, it will be presumed that such avoidance has for its sole or main purpose to obtain a tax benefit until proven otherwise by the taxpayer.

On the issue of the onus of proving the existence of any of the tainted elements, Olivier is of view that on the strength of the *Conhage*[69] case, it would appear that the onus is on CSARS to prove the abnormality, lack of commercial substance and misuse or abuse requirements notwithstanding S 82 of the ITA.[70] It must here be highlighted that there are merits in Olivier's views; in a foreign case, the Supreme Court of Appeal of Canada held that the onus rests on the Commissioner to prove that there was an abusive tax avoidance transaction under S 245(4), in the sense that it cannot be reasonably concluded that a tax

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[67] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA), p 397

[68] SOUTH AFRICA. National Treasury Department, 2011, *SARS Draft Comprehensive Guide to General Anti-Avoidance Rule*, Government Printer, P 18

[69] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA)

[70] L. Olivier et al, Juta's on Income Tax, 2009, Revision service 14, p 80G-1; Also refer SOUTH AFRICA. National Treasury Department, 2011, *SARS Draft Comprehensive Guide to General Anti-Avoidance Rule*, Government Printer, P 24

benefit would be consistent with the object, spirit or purpose of the provisions as relied by the taxpayer.[71]

The National Treasury's explanation for the introduction of section S 80G of the ITA is that it has the purpose to expose a step or part that has the sole or main purpose of obtaining a tax benefit which may no longer be "camouflaged" by the legitimate purpose of the arrangement as a whole.[72]

Therefore for a taxpayer to discharge the onus placed by S 82 and S 80G of the ITA, a mere assertion that tax avoidance was not the sole or main purpose, will not suffice.[73] Although the courts tend to view and give due consideration and weight to a taxpayer's ipse dixit,[74] the taxpayer will have to produce to the courts satisfactory evidence and the circumstances for entering a particular transaction to discharge the onus of proving that it does not have for its sole or primary motive a tax benefit.

3.5 The Court's interpretation of ITA and GAAR

Since the provisions of Part IIA of the ITA are relatively new there has not been any case which has been heard by our courts on this subject. It is therefore important to consider the likelihood of how the courts may interpret Part IIA of the ITA. Although the rules of interpretation are not confined only to the GAAR but to the fiscal legislation as a whole, the precedents from the courts are a useful indication. Generally in the interpretation of statutes including the ITA, the courts have adopted two approaches namely, the traditional

[71] *Canada Trustco Mortgage Company v Canada* 2005 SCC 54

[72] SOUTH AFRICA. National Treasury Department, 2006, *Explanatory Memorandum on the Revenue Laws Amendment Bill 2006*, Government Printer, p 65

[73] *Ovenstone v SIR* 1980 (2) SA 721 (A)

[74] *Malan v Kommissaris Van Binnelandse Inkomste* 1983 (3) SA 1(A)

approach or the modern approach. It is submitted that both approaches are not mutually exclusive because their application can be intertwined.[75]

3.5.1 The traditional approach

The traditional approach of the interpretation of the fiscal legislation, involves a literal interpretation of the Act and its application to the particular facts and circumstances. The courts have in certain distinct instances, especially where there is an ambiguity or absurdity in the legislation, departed from its literal meaning to give the real intention of the legislature.

In the case of *Glen Anil Development Corporation*,[76] it was held that fiscal legislation should not be interpreted differently to other legislation and the true intention of the legislature is of paramount importance. In delivering his judgment, Hefer JA quoted with approval the dictum stated by Lord Cairns in *Partington v The Attorney-General*:[77]

"If the person sought to be taxed comes within the letter of the law, he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the law the case might otherwise appear to be. In other words, if there be an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute".[78]

[75] L. Van Schalkwyk et al, 2009, Section 80A (c) (ii) of the Income Tax Act and the interpretation of tax statutes in South Africa, *Meditari Accountancy Research*, 17 (3): p169

[76] *Glen Anil Development Corporation v SIR* 1975 (4) SA 715 (A)

[77] 21 LT 370 at 375; *CIR v George Forest Timber Co Ltd* 1924 AD 516224 at 531-2

[78] Also quoted with approval by Wessels CJ in the *CIR v Delfos* 1933 AD 242, p254

However, our courts have also highlighted the dangers of speculating on the intention of the legislature. In the *Savage*[79] case, in delivering his judgment, Centrlivres CJ quoted with approval the dictum of De Villiers JA, who stated that:

"Moreover, as has often been remarked by eminent Judges, 'it is dangerous to speculate as to the intention of the Legislature, and what seems an absurdity to one man does not seem absurd to another'. The absurdity must be utterly glaring and the intention of the Legislature must be clear, and not a mere matter of surmise or probability".[80]

In the same vein, in a more recent case, Coetzee J stressed the fact that the principles applied in the interpretation of tax statues are similar to other statues, in the sense that one must look fairly at the language used to determine the intention of the legislature.[81]

It was previously accepted by the courts that equity is not a subject matter in the interpretation of fiscal legislation and the burden of tax must be enforced by the courts however unfair or inequitable it may appear to be to the taxpayer.[82] However, due consideration must also be given to S 39[83] of the Constitution of South Africa, which enforce equality and fairness in the interpretation of any legislation.

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[79] *Savage v CIR* 1951 (4) SA 400(A)

[80] *Shenker v The Master and another* 1936 A.D. 136; Also refer to the judgement of Innes CJ in *CIR v George Forest Timber Company Limited* 1924 AD 516, p 23

[81] *SIR v Kirsch* 1978 (3) SA 93 (T), p97

[82] Lord Cairns in *Partington v The Attorney-General* 21 LT 370

[83] (1) "When interpreting the Bill of Rights, a court, tribunal or forum-

(a) must promote the values that underlie an open and democratic society based on human dignity, equality and freedom;

(b) must consider international law; and

(c) may consider foreign law

(2) When interpreting any legislation, and when developing the common law or customary law, every court, tribunal or forum must promote the spirit, purport and objects of the Bill of Rights."

3.5.2 The modern approach

The modern approach of the interpretation of the fiscal legislation seeks to ascertain the real purpose of the legislation by looking at it in a particular context, rather than speculating on the legislature's intention. Hefer JA by using this approach has given a purpose to the anti-avoidance provision of S 103(2), where he stated the following:

> "In any event I do not understand the rule to be that every provision of a fiscal statute, whether it relates to the tax imposed or not, should be construed with due regard to any rules relating to the interpretation of fiscal legislation. Section 103 of the Act is clearly directed at defeating tax avoidance schemes. It does not impose a tax, nor does it relate to the tax imposed by the Act or to the liability there for or to the incidence thereof, but rather to schemes designed for the avoidance of liability there for. It should, in my view, therefore, not be construed as a taxing measure but rather in such a way that it will advance the remedy provided by the section and suppress the mischief against which the section is directed (Hleka v Johannesburg City Council 1949(1) SA 842(AD) at 852, and see generally Maxwell Interpretation of Statutes 12 ed 40 et seq). The discretionary powers conferred upon the Secretary should, therefore, not be restricted unnecessarily by interpretation".[84]

The definition of a detailed purposive construction was also given by Hurt AJA in the more recent case of *Airworld CC and another*,[85] where the Court had to decide on the purpose of Ss 64B and 64C of the ITA. The learned Judge formulated this approach in the following four-fold process:

a. To consider the words in the legislation to decide whether the meaning is clear;

b. To consider whether the word, properly considered in its context, is nevertheless ambiguous;

c. If there is an ambiguity, use the rules of interpretation to resolve such ambiguity and arriving at an interpretation which accords as well as possible both with the language which the legislature has used and with its apparent intention;

[84] *Glen Anil Development Corporation v SIR* 1975 (4) SA 715 (A), p334

[85] *CSARS v Airworld CC and Another* [2007] SCA 147 (RSA), p59

d. To endeavour to arrive at an interpretation that gives effect to that purpose.

In a more subjective approach, Wunsh J, stressed the fact that the rule in the interpretation of tax avoidance provisions should be construed in such a way that it will advance the remedy provided thereby and suppress the mischief against which it is directed.[86] The modern (purposive) approach was also favoured in the *De Beers* case, Nienaber JA stated that "the language of a provision must take its colour, like a chameleon, from its setting and surrounds in the Act".[87]

3.5.3 Foreign courts interpretation

In the *Canada Trustco*[88] case, the Supreme Court of Appeal of Canada held that that for the interpretation of the misuse and abuse test as provided by S 245(4), the following two-fold step must be undertaken:

I The courts must conduct a unified textual, contextual and purposive analysis of the provisions giving rise to the tax benefit in order to determine why they were put in place and why the benefit was conferred. The goal is to arrive at a purposive interpretation that is harmonious with the provisions of the Act that confer the tax benefit, read in the context of the whole Act;

II The court must examine the factual context of the case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue

[86] ITC 1611 59 SATC 126, p136-137

[87] *De Beers Marine (Pty) Ltd v CSARS* [2002] 3 All SA 181 (A), Para 7; Also similar decisions were reached in *Standard General Insurance Company Ltd v CCE* [2004] 2 All SA 376 (SCA), *Metropolitan Life Ltd v CSARS* [2008] 70 SATC 162

[88] *Canada Trustco Mortgage Company v Canada* 2005 SCC 54

It is worth noting that the principles of interpretation of the Canadian ITA in *Canada Trustco's*[89] case is perfectly harmonised with the principles as laid by Hurt AJA in the *Airworld's*[90] case, in the sense that when the words of a provision are precise and unambiguous, the ordinary meaning of the words plays a dominant role in the interpretive process. On the other hand, in the event of any uncertainty or ambiguity, the Court will arrive at an interpretation which accords as well as possible both with the language which the legislature has used and with its apparent intention and purpose.

3.5.4 Conclusion

As shown above, some of the recent decisions emanating from the courts in South Africa demonstrate that a modern approach of interpretation of fiscal legislation is more favoured than the traditional approach.[91] Furthermore since the powers conferred to the CSARS under the 'remedies' provisions[92] of new GAAR are very wide, the courts are likely to limit these powers.[93]

It is also worth to be noted that there are also opposing views of whether the courts will favour the application of a purposive approach in our courts due to the fact that our jurisprudence is very different from that of Canada and our courts will not adopt a purposive approach in interpreting a statute i.e. a consideration of the intention of the legislature, unless ambiguity and lack of clarity is present in the wording of the particular section.[94]

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[89] *Canada Trustco Mortgage Company v Canada* 2005 SCC 54

[90] *CSARS v Airworld and Another* [2007]SCA147 (RSA)

[91] L. Van Schalkwyk et al, 2009, Section 80A(c)(ii) of the Income Tax Act and the interpretation of tax statutes in South Africa, *Meditari Accountancy Research*, 17 (3): p183

[92] S80 B of the ITA

[93] Huxham, K & Haupt, P "Notes on South African Income Tax – 2010", p. 459

[94] Prof Peter Surtees, Template for applying GAAR. Cape Town: University Of Cape Town [Course notes]

3.6 The old GAAR and the requirements for its successful application

Prior to 2 November 2006, S 103(1) of the ITA dictated the general anti-avoidance provision. Its requirements for a successful application by the Commissioner, was that the following must be present:

(a) There must be a 'transaction, operation or scheme' that has been entered into which results in the avoidance, reduction or postponement of a tax liability levied in terms of the ITA. The 'transaction, operation, or scheme' in issue must have been entered into solely or mainly for the purpose obtain a "tax benefit".

The term 'transaction, operation or scheme' has been interpreted to be of such wide import that it is difficult to conceive how any question of tax benefit could arise without there being a transaction operation or scheme. The provisions of S 103 can be applied only if the transaction, operation or scheme in issue, is covered by the terms of that section, if it's not then provisions cannot be applied.[95]

In the case of *Meyerowitz v CIR*,[96] it was held that the word 'scheme' is a wide term which is sufficiently wide to cover a series of transactions within the meaning of section 90 (the predecessor to S 103(1) of the ITA). It was further held in that case that where a transaction was entered into for bona fide commercial reasons but when that transaction subsequently become part of the scheme, it ceases to be an innocent bystander.

[95] *CIR v King*, 1947 (2) SA 196 (A), p 209

[96] *Meyerowitz v CIR*, 1963 (3) SA 863(A), 25 SATC 287

In the case of *SIR v Gallagher*,[97] in delivering his judgment, Corbett JA, held that if the purpose of the transaction, operation or scheme does not have the effect of avoidance, postponement or reduction of income tax, then S 103(1) is inapplicable.

In the case of *CIR v Conhage*,[98] the taxpayer took advantage of the benefits of sale and leaseback transactions with a financial institution to buy equipments for its expansion. Since the ITA does not distinguish between financial and operational leasing transactions, the taxpayer could deduct the lease payments as rentals under S 11(a) of the ITA. Thus the Commissioner sought to invoke S 103(1) of the ITA to attack this scheme. The SCA agreed in the findings of the Special Court in that the main purpose for entering this transaction was not to obtain a tax benefit but to raise capital of its expansion program. The taxpayer had the choice of choosing the most efficient tax manner in raising capital and thus preferred that choice. The Court also found that the choice made by the taxpayer would make perfect business sense and thus S 103(1) could not be invoked by CSARS.

(b) The transaction, operation or scheme must have been entered into in a manner that would not normally be entered for bona fide business purposes other than to obtain a tax benefit. The said transaction, operation or scheme has created abnormal rights and obligations which would have normally been created between persons dealing at arm's length.

It is to be noted that both element listed in (a) and (b) must exist for a successful application of S 103(1) of the ITA. In the case of *SIR v Geustyn, Forsyth & Joubert*,[99] it was held that although the transactions, operations or scheme was 'abnormal', S 103(1) of

[97] *SIR v Gallagher* 1978 (2) SA 463 (A)

[98] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd*), 1999 (4) SA 1149 (SCA)

[99] 1971 (3) SA 567 (A)

the ITA could not be applied if the taxpayer had discharged the onus to prove that the transaction entered into, does not have for its sole or main purpose to avoid tax.

On the other hand, in the case of *SIR v Hicklin*,[100] it was held that the taxpayer did not discharge its onus to prove that tax avoidance was not the sole or main purpose for entering into an agreement with a dividend stripping company. However, since the parties involved were dealing at arm's length, each parties will strive to obtain the utmost possible advantage out of the transaction, therefore the rights and obligations so created will more likely be normal than abnormal. Since the abnormality requirement was not present, the Commissioner could not invoke S 103(1) of the ITA.

3.7 Common law principles / judicial doctrines

As point of departure, prior to applying the provisions of S 103(1) the court may establish whether the substance of the transaction differs from its form, in other words the court needs to apply the "*simulated transaction doctrine*". The application of the said doctrine entails an enquiry into the true nature of the activity, as opposed to its purported form. If it is established that a trust is a sham trust, there would be no need for the application of S 103(1) or Part IIA of the ITA, as under this doctrine, the court may order that the entire trust be disregarded as if it had never existed.

The courts both local and foreign had over the years refined this doctrine and the meaning of a 'simulated transaction' as is outlined hereunder:

In the *Dadoo's*[101] case, Innes CJ described a simulated transaction as:

[100] 1980 (1) SA 481 (A)

[101] *Dadoo Ltd and Others v Krugersdorp Municipal Council* 1920 AD 530

"a transaction is in *fraudem legis* when it is designedly disguised so as to escape the provisions of the law, but falls in truth within these provisions. Thus stated, the rule is merely a branch of the fundamental doctrine that the law regards the substance rather than the form of things – a doctrine common, one would think, to every system of jurisprudence and conveniently expressed in the maxim *plus valet quod agitur quam quod simulate concipitur.*"

The court in *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*,[102] dealt with the application of simulated transaction doctrine and held as follows:

"…The parties to it do not really intend to have, *inter partes*, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing what is the real agreement or transaction between the parties. The parties wish to hide the fact that the real agreement or transaction falls within the prohibition or is subject to the tax, and so dressed it up in a guise which conveys the impression that it is outside of a prohibition or not subject to the tax".[103]

The above cases have also been quoted with approval by the court in the latter case of *Ladysmith.*[104]

In the United Kingdom case of *Bridge v Campbell Discount Co Ltd*,[105] Lord Devlin said:

"When a court of law finds that the words which the parties have used in a written agreement are not genuine, and are not designed to express the real nature of the transaction but for some ulterior purpose to disguise it, the court will go behind the sham front and get at the reality".

In the Australian case of *Sharment Pty Ltd v Official Trustee in Bankruptcy*[106] Lockhart J defined a sham as:

[102] 1941 AD 369; *Zandberg v Van Zyl*, 1910 AD 302, p 309

[103] *Commissioner of Customs and Excise v Randles, Brothers and Hudson Ltd*, 1941 AD 369, Pg 396

[104] 1996 (3) SA 942 (A), 58 SATC 229

[105] [1962] AC 600

[106](1988) 18 FCR 449

"A sham is for the purposes of Australian law, something that is intended to be mistaken for something else or that is not really what it purports to be. It is a spurious imitation, a counterfeit, a disguise or a false front. It is not genuine or true, but something made in imitation of something else or made to appear to be something which it is not. It is something which is false or deceptive […] important to this description is the idea that the parties do not intend to give effect to the legal arrangements set out in their apparent agreement, understood only according to its terms. In Australia, this has become essential to the notion of sham, which contemplates a disparity between the ostensible and the real intentions of the parties. The courts must therefore test the intentions of parties, as expressed in documentation, against their own testimony on the subject (if any) and the available objective evidence tending to show what that intention really was".

The question of whether Lord's Tomlin remark in the case of *Duke of Westminster,*[107] as outlined hereunder, is in conflict with the substance versus form doctrine has also been addressed by our courts.

"Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however unappreciative the Commissioners of Inland Revenue or his fellow-taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax".

Innes J's in his judgment in *Zandberg v Van Zyl*[108] held the following:

"But the words of the rule indicate its limitations. The court must be satisfied that there is a real intention, definitely ascertainable, which differs from the simulated intention. For if the parties in fact mean that a contract shall have effect in accordance with its tenor, the circumstances, that the same object might have been attained in another way will not necessarily make the arrangement other than it purports to be. The enquiry, therefore, is in each case one of fact, for the right solution of which no general rule can be laid down".

[107] *IRC v Duke of Westminster*, 1936, 19 TC 490, p520

[108] 1910 AD 302 , p 309

It was also explained in the case of *Commissioner of Customs and Excise v Randles, Brothers & Hudson Ltd*[109] that:

> "[a] transaction is not necessarily a disguised one because it is devised for the purpose of evading the prohibition in the Act or avoiding liability for the tax imposed by it. A transaction devised for that purpose, if the parties honestly intend it to have effect according to its tenor, is interpreted by the court according to its tenor, and then the only question is whether, so interpreted, it falls within or without the prohibition or tax".

In the case of *Ladysmith (Pty) Ltd v CIR*,[110] Hefer JA, with reference to the above cited cases, explained that a disguised transaction in essence is a dishonest transaction, in as much as the parties to it do not really intend it to have, the legal effect which its terms convey to the outside world. The purpose of the disguise is to deceive by concealing the real transaction, to hide the fact that their real agreement falls within the prohibition.

The principles of the aforementioned cases were fully applied in the *Conhage*[111] case, in deciding whether lease and sale back agreements were a simulated transaction. Under this scheme, the taxpayer was entitled to deduct the lease payments under S 11(a) of the ITA as the asset was in fact owned by the financial institution and the taxpayer was merely renting those assets from them.

The Commissioner on the other hand was of view that this transaction was simulated and the real intention of the taxpayer was to contract a loan with the financial institution and thus the taxpayer sought to deduct both the interest and capital portion of the loan under S 11(a) of the ITA. The court was satisfied that the real intention of the parties were in fact to abide by the lease and sale back agreement to raise finance for their expansion project.

[109] 1941 AD 369, p395

[110] *ERF 3183/1 Ladysmith (Pty) Ltd v CIR*, 1966 (3) SA942 (A), 58 SATC 229

[111] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA)

Thus the said agreements were entered in a bona fide business transaction although tax motive was one of the main purposes. The result thereof was that the common law doctrine could not be applied to the agreements in issue, as there were no disguised transactions.

3.7.1 Examples where the court has pierced the trust due to improper administration (Sham Trusts)

(I) In *Land and Agricultural Bank of South Africa v Parker*[112] the trustees abused their powers and acted in contravention to the charter of the trust, i.e. the trust deed. The trust deed in this case provided that there should be a minimum of three trustees at all material times. When one trustee resigned the remaining trustees failed to appoint a third one and furthermore the two trustees had entered into agreements with Land and Agricultural Bank of South Africa, whereby assets of the trust were given as surety to obtain a substantial loan in favour of associated companies of their family business. The Parkers defaulted on their loan repayments and the bank sought to sequestrate the Parkers and the trust. The Parkers contended that two trustees alone could not bind the trust as the trust deed provided for a minimum of three trustees in office and thus the two trustees acting alone did not have the authority to bind the assets of the trust and therefore the sequestration order should be set aside.

The Supreme Court of Appeal held that that the two trustees had lacked the capacity to bind the trust in favour of the bank in the first place. However, following a sequestration order against Parker, his trusteeship was automatically terminated in terms of a clause in the trust deed. Nevertheless, Parker signed the trust's petition to appeal in his purported capacity as a trustee. It followed therefore that, based on the same principle of lack of

[112] 2005 (2) SA 77(SCA)

capacity the appeal to the full bench had been invalid and should have been struck from the roll. There had therefore never been a valid appeal against the sequestration order, and it stood against the trust in favour of the bank. In delivering his judgment, Cameron JA expressed the following:

> "It may be necessary to go further and extend well-established principles to trusts by holding in a suitable case that the trustees' conduct invites the inference that the trust form was a mere cover for the conduct of the business 'as before', and that the assets allegedly vesting in trustees in fact belong to one or more of the trustees and so may be used in satisfaction of debts to the repayment of which the trustees purported to bind the trust. Where trustees of a family trust, including the founder, act in breach of the duties imposed by the trust deed, and purport on their sole authority to enter into contracts binding the trust, that may provide evidence that the trust form is a veneer that in justice should be pierced in the interests of creditors".[113]

The lesson to be learn from this case is that, failure to administrate the trust in terms of its charter and contravention to the Act[114] could defeat the very purpose for which the trust has been created and the authorities may allow the trust to be pierced as though is never existed at first place. The other lesson to be learnt from a creditors point of view, is that it should never be assumed have trustees are acting within the boundaries of their powers as provided trust deed.

(II) In the *Badenhorst v Badenhorst*[115] case, the issue was when making a redistribution order in terms of S 7(3) of the Divorce Act 70 of 1979, the assets of an inter vivos discretionary trust created during the marriage must be taken into account. In deciding in favour of the appellant (Defendant), the SCA's findings were that the respondent (Plaintiff)

[113] *Land and Agricultural Bank of South Africa v Parker*, 2005 (2) SA 77(SCA), Para 37.3

[114] Trust Property Control Act 57 of 1988

[115] 2006 (2) SA 255 (SCA)

has indeed treated the trust as his alter ego and it was evident that, but for the trust, ownership in all the assets would have vested in him. This decision has been reached based on the following salient facts as set out on Para 11 of the judgment:

1. In conducting the affairs of the trusts, the plaintiff seldom consulted or sought the approval of his co-trustee, the was therefore in full control of the trust;
2. He listed the trust assets as his own, in the application for credit facilities with the local co-operative;
3. The liabilities in the form of bonds over the fixed property and then rental income from the buildings was also described as his;
4. He insured a trust asset in his own name
5. A property registered in the name of the plaintiff was financed by the trust;
6. He received an income of R50 000 per month from an estate agency owned by the trust.

(III) In the *Airworld's*[116] case, the sole member of two close corporations prompted the two close corporations to make substantial interest free loans to his family trust (a discretionary trust) to finance the purchase of assets. The CSARS viewed that the interest free loans were a disguise and accordingly assessed the two close corporations for STC in terms of Ss 64B and 64C of the ITA, as the Trust was a 'recipient' of amounts deemed to have been declared as dividends because the member of the close corporations, was a 'beneficiary' of the Trust as contemplated by the definition of 'recipient' in S 64C(1)(*c*) of the ITA.

[116] CSARS v Airworld and Another [2007]SCA147 (RSA), 70 SATC 48

On the other hand, the respondents (taxpayers) contended that if regard is had to the definition of 'beneficiary' for the purposes of defining the expression 'connected person' in S 1 of the ITA, it appeared that the legislator intended to draw a distinction between a beneficiary who had a vested right to claim benefits from a trust and a beneficiary in respect of whom the trustees had a discretion to confer benefits and where the word was used without any qualification, it should be assumed that it was used in the sense of a 'beneficiary with a vested right' as in a discretionary trust the beneficiary was only a 'potential beneficiary' until the trustees had exercised their discretion and decided to make a payment to him or grant him some other benefit out of the trust.

The SCA have had a clear view of the taxpayers' mischief and ruled that the trust was a beneficiary within the meaning of S 64C. In arriving to that conclusion, the SCA had examined closely the control and influence of the founder (and also the sole member of the two close corporations) over the trust and the other trustees. In delivering his judgment, Hurt AJA stated the following:

> "The striking feature of it, in relation to this case, is that the only conceivable beneficiaries are Retief, his spouse and their descendants. All of these beneficiaries fall squarely within the ambit of sub-s 64C(1)(*c*). This is accordingly not a type of trust in which the trustees have a discretion to benefit anyone other than 'recipients' as defined in the subsection. The authority of Retief plainly pervades the trust. His co-trustee, Mr JD Coetzee, acknowledged in the course of his evidence that Retief is a headstrong man who ignores advice if it doesn't suit his wishes. Both his co-trustees are employed by Retief and, indeed, the evidence was that the Coetzee family had been employed as accountants and auditors of the Retief family businesses since the mid 1950's. The circumstances are strikingly similar to those outlined in *Badenhorst v Badenhorst* (2006 (2) SA 255 (SCA) para 10 and 11). For all practical purposes a payment to the Trust is equivalent to a payment to Retief, for he has the power to direct its ultimate destination. It would, in my view, be ludicrous for the respondents to be able to rely on the circumstance that the trustees had not yet made a decision to

pay any amount out of the trust to any of the beneficiaries, to avoid liability for STC. Such a result would fly in the face of the legislators clear intention”.[117]

3.8 A comparison between the old GAAR and the new GAAR

(a) Transaction, operation or scheme

The terms ‘transaction, operation or scheme’ as contained in the repealed S 103(1) of the ITA, have also been incorporated in the new GAAR under the definition of ‘arrangement’ in S 80L of the ITA and should retain its previous interpretation from our courts.[118] However, the two main differences from its predecessor are the following:

(1) That it is not a requirement for any such transaction, operation or scheme to be legally enforceable in order to fall within the ambit of Ss 80A and 80L of the ITA, the wording of these new provisions originates from S 177A(1) of the Australian Income Tax Act;[119]

(2) That the term ‘arrangement’ includes all steps in the ‘transaction, operation or scheme’ or parts thereof and by virtue of the powers conferred to CSARS by virtue of S 80H of the ITA, the latter may apply GAAR to any steps or parts within the ‘transaction, operation or scheme’. This approach was developed in UK where Lord Brightman had observed the following:

> *"The fact that the court accepted that each step in a transaction was a genuine step producing its intended legal result-did not confine the court to considering each step in isolation for the purpose of assessing the fiscal result."*[120]

[117] *CSARS v Airworld and Another* [2007]SCA147 (RSA), 70 SATC 48, p65

[118] *CIR v King*, 1947 (2) SA 196 (A), p 209; *Meyerowitz v CIR*, 1963 (3) SA 863(A), 25 SATC 287

[119] SOUTH AFRICA. National Treasury Department, 2011, *SARS Draft Comprehensive Guide to General Anti-Avoidance Rule*, Government Printer, P 13

[120] *Furniss v Dawson* [1984] AC 474 HL, P239

This requirement may have far reaching consequences on the 'purpose' requirement as it seeks to override established case law[121] in South Africa wherein the courts would look at the transactions as a whole, as opposed to the individual steps contained therein and thus the taxpayer was able to show that there was an overriding non-tax reason for the conclusion thereof.[122] The CSARS would thus be able to apply the provisions of the new GAAR to the 'single' step, which has for the sole or main purpose of obtaining a tax benefit and ignoring the purpose of the overall arrangement.

Silke in paragraph 19.4, using the precedent in the case *FCT v Newton*,[123] defines that an "'arrangement' requires a conscious involvement of two or more participants who arrive at an understanding. It cannot exist in a vacuum and presupposes a meeting of minds, which embodies an expectation as to future conduct between the parties, that is, an expectation by each that the other will act in a particular way". The implication of the above statement indicates that all parties to an arrangement must be in agreement or reach a consensus with all the relevant terms and conditions of the arrangement.[124]

(b) The sole or main purpose requirement

The sole or main purpose requirement is fundamental in both the old and new GAAR, if the sole or main purpose of entering a transaction, operation or scheme was motivated by

[121] *Hicklin v SIR*, 1980 (1) SA 481 (A); *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA); *SIR v Geustyn, Forsyth & Joubert*, 1971 (3) SA 567 (A)

[122] SOUTH AFRICA. National Treasury Department, 2011, *SARS Draft Comprehensive Guide to General Anti-Avoidance Rule*, Government Printer, P 15

[123] *Newton v FCT*, [1958] 2 All ER 759 (PC)

[124] Silke on Income Tax, 2011, LexisNexis, electronic version

reasons other than tax benefits, S 103(1) of the ITA could not be applied[125] and same principles would seemingly still apply in the new GAAR.

Previously in determining the purpose requirement of a particular transaction, operation or scheme, our courts had adopted a subjective approach where much reliance were placed on the '*ipse dixit'* of the taxpayer rather than the effect of such transaction, operation or scheme.[126]

It is submitted that under the new provision of S 80A, in determining the purpose requirement, there is a shift from the subjective approach to an objective approach whereby if the effect of such transaction, operation or scheme, results in a tax benefit, it will be presumed that such transactions (or part therein as defined in S 80L of the ITA) had been entered with the sole or main purpose to obtain a tax benefit in terms of S 80G of the ITA.[127] The 'effect' approach has also been favoured over the 'purposive or choice' approach in some very well known UK cases.[128]

If such a new approach is adopted by our courts, it would nullify the 'choice' principles as formulated by our courts[129] and also by the Canadian courts.[130] Therefore under such an interpretation, the taxpayer will be under a tremendous disadvantage as it would be very

[125] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA); *SIR v Geustyn, Forsyth & Joubert*, 1971 (3) SA 567 (A)

[126] *SIR v Gallagher*, 1978(2) SA 463 (A), p471; *SIR v Geusteyn, Forsyth and Joubert*, 1971(3) SA567 (A); *Glen Anil Development Corp Ltd v SIR*, 1975(4) SA 715, p730H

[127] SOUTH AFRICA. National Treasury Department, 2011, *SARS Draft Comprehensive Guide to General Anti-Avoidance Rule*, Government Printer, p20:21

[128] *W. T. Ramsay Ltd. v. Inland Revenue Commissioners* [1982] A.C. 300; *Barclays Mercantile Business Finance Limited v Mawson (Inspector of Taxes)* [2005] 1 All ER 97; *Furniss v Dawson*, [1984] AC 474 HL

[129] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA)

[130] *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601, 2005 SCC 54

difficult to discharge the burden as imposed under S 80G (previous equivalent was S 103(4)) of the ITA).[131] It is also worth to be noted that such an interpretation of GAAR has not been viewed in a favourable light in some foreign jurisdictions.[132]

Example

A taxpayer who enters in a transaction to acquire an investment flat by the interposition of a trust; therefore instead of purchasing the immovable property on his own name, he opts to set up and inter-vivos trust, in which he is one of the trustees and also one of the beneficiaries. The taxpayer then lends a sum of money to the trust to purchase the property.

The first enquiry is to determine under both the old and new GAAR whether a 'tax benefit' is derived under the 'arrangement' in issue. The tax benefit in this issue is the anticipated tax liability[133] at death of the donor/founder to the trust (CGT and estate duty).

On the strength of the *Conhage*[134] case, such an arrangement would not meet the 'sole or main purpose requirement' under the previous S 103(1) of the ITA as the taxpayer's main purpose to enter the series transactions as outlined above, was to purchase an immovable property and not to obtain a tax benefit.

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[131] The Taxpayer, Volume 54 No. 11, November 2005, p 205

[132] *Jabs Construction Ltd. v. The Queen*, [1999] 3 CTC 2556, Para 48; *Canada Trustco Mortgage Co. v. The Queen*, [2003] 4 CTC 2009, Para 77; *Fredette v. The Queen*, [2001] 3 CTC 2468, Para 76; *Geransky v. The Queen*, [2001] 2 CTC 2147, Para 42 -43

[133] *CIR v King*, 1947 (2) SA 196 (A), 14 SATC 184; *Smith v CIR*, 1964 (1) SA 324 (A)

[134] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA); Also *SIR v Gallagher*, 1978(2) SA 463 (A)

Since the ambit of the provisions of the new GAAR is very wide, the above 'arrangement' may thus take a different shape, taking into consideration the definition of 'arrangement' in S 80L and also to the powers conferred to the CSARS in S 80H. It is further submitted that these new provisions effectively seek to overcome the rules of 'purpose requirement' as laid in *Conhage*[135] and *Hicklin*[136] whereby if the taxpayer could show an overriding non-tax reasons for entering in a composite arrangement S 103(1) of the ITA could not be invoked.[137]

Therefore under the new provisions, whenever a 'tax benefit' is achieved viewed in an objective perspective, it will then be presumed under S 80G of the ITA, that its sole or main purpose is to avoid tax, the Commissioner may then subject part or all of the 'composite arrangement' that results in a 'tax benefit' to GAAR if the taxpayer does not discharge the onus as imposed on him by S 80G of the ITA. The taxpayer would need to advance satisfactory reasons, which will then be tested against the surrounding facts and circumstances of the case to discharge that onus. On a closer analysis, it would seem that CSARS interpretation of the purpose requirement is that whenever an 'arrangement' results in a tax benefit, the purpose requirement will be satisfied if same results could be achieved in a non-tax saving arrangement. (In this example, the set up of a testamentary trust). Hence the 'arrangement' may fall under the first requirement of GAAR namely the 'sole or main purpose to obtain a tax benefit'.

[135] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA)

[136] *Hicklin v SIR*, 1980 (1) SA 481 (A)

[137] SOUTH AFRICA. National Treasury Department, 2011, *SARS Draft Comprehensive Guide to General Anti-Avoidance Rule*, Government Printer, p15

(c) Tainted Elements

The tainted elements that prevailed under the old GAAR[138] were the normality or abnormality of the transactions, operation or scheme in issue, having regards to both a business and non-business context. In order to establish whether a person is conducting a business is a factual enquiry as described by Wessels J in the *Modderfontein*[139] case. Previously in assisting the CSARS in discharging its onus to prove the normality requirement,[140] there was the indicative test of 'rights and obligation created under transactions dealt at arm's length'.

The terms 'normality' and 'abnormality' were not defined in the ITA and therefore have to take precedence on case laws.[141] In establishing the normality of a transaction there are no predetermined set of rules that can be applied, the courts have applied the context of the transactions, operation or scheme in issue to the particular facts and circumstances of the case. It was established that in an event where a transaction has been dealt at arm's length, the transaction would more likely be 'normal' than 'abnormal' since the parties involved would each seek to maximise their gains.[142]

The above concepts have been retained in the new GAAR; the normality and abnormality requirement in a business context is now covered by S 80A(a) and in a context other than a business is covered in S 80A(b) of the ITA.

[138] S 103(1)(b)(i) of the ITA

[139] *Modderfontein Deep Levels Ltd v Feinstein*, 1920 TPD 288

[140] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA)

[141] *Meyerowitz v CIR*, 1963 (3) SA863 (A), 25 SATC 287; *Hicklin v SIR*, 1980 (1) SA 481 (A); *CIR v Louw*, 1983 (3) SA 551 (A), 45 SATC 113; *Ovenstone v SIR* 1980 (2) SA 721 (A)

[142] *Hicklin v SIR*, 1980 (1) SA 481 (A)

However, the tainted elements tests have further been expanded under the new GAAR with the introduction of an additional three more tainted 'elements' tests namely, the commercial substance test,[143] the non- arm's length transaction test[144] and the misuse and abuse test.[145] The commercial substance test is further expanded in a list of non exhaustive indicative test as provided in Ss 80C, 80D and 80E of the ITA.

(d) Lack of commercial substance

It would seem that it was the legislature's intention to codify the doctrine of substance versus form, by the insertion of S 80C, the explanation given by the treasury of this insertion is that these provisions draw upon precedent in both the United Kingdom and the United States and would adopt what the House of Lords has referred to as an "unblinkered" approach to complex multi-step "composite transactions". It seeks to expand the scope of the narrow common law doctrine of substance over form.[146]

(i) Round Trip Financing

The round trip financing concept has been introduced in the South African GAAR under S 80D of the ITA; it is an indicative element of the presence of a 'lack of commercial substance'. The meaning thereof is where funds are transferred from one source and takes a 'journey' to some other recipients and back again to its original source. The term 'round trip financing' had been considered in the UK, where Lord Wilberforce[147] made the following remarks:

[143] S 80A(a)(ii) of the ITA

[144] S 80A(c)(i) of the ITA

[145] S 80A(c)(ii) of the ITA

[146] SOUTH AFRICA. National Treasury Department, 2006, *Explanatory Memorandum on the Revenue Laws Amendment Bill 2006*, Government Printer, p 64

[147] *Ramsay v Inland Revenue Commissioners*, [1982] A.C 300, p 322

"although sums of money, sometimes considerable, are supposed to be involved in individual transactions, the taxpayer does not have to put his hand in his pocket: see Inland Revenue Commissioners v. Plummer [1980] A.C. 896 and Chinn v. Hochstrasser. The money is provided by means of a loan from a finance house which is firmly secured by a charge on any asset the taxpayer may appear to have, and which is automatically repaid at the end of the operation."

Applying the above concept in a context involving a trust, whereby the donor's attempt to circumvent the trap of Para 12(5) on deemed waiver of loan on donations. The donation can be structured in a manner in which cash is donated instead of a waiver of loan account, as the definition of "asset" in Para 1 specifically excludes any currency. Trust income or capital, in cash can be utilised by the trust to repay the loans to the founders of the trust. The founders/donors can thereafter donate the cash of R100,000 each to the trust. This donation will be exempt from donations tax in terms of S 56(2)(b) of the ITA and there will be a further tax benefit of R 20,000 on avoidance of CGT by the trust. In this circumstance the arrangement may be regarded as a round trip financing and thus fall within the ambit of S 80D of the ITA.

However, from the wording as contained in provisions in Ss 80A(a) and 80D, it would seem that the round trip financing can only apply in a business context. A further enquiry would therefore need to be undertaken to determine whether the trust is trading[148] and carrying on a business.[149]

(ii) Elements that have the effect of cancelling each other

This indicative test, as provided in S 80C(b)(iii) originates from S 245(4) of the Canadian ITA and from the British doctrine of 'fiscal nullity' which has been interpreted in the

[148] The definition of 'Trade' in Section 1 of the ITA

[149] *Modderfontein Deep Levels Ltd v Feinstein*, 1920 TPD 288

Furniss v Dawson's case[150] as a planned series of transactions which has the effect of cancelling each other purely to avoid tax.

In a context of transaction(s) involving trust(s), the above provisions could be triggered or in a situation whereby donors to a trust attempt to offset capital gain attributed by the trust to them in their capacity as beneficiaries against the capital loss incurred as a result of the waiver of loan[151] in their capacity as donors/ creditors.

(iii) Accommodating or tax –indifferent parties

It may further be contended by the fiscus that the transaction in (ii) above, is also designed to accommodate a connected party[152] (the trust) to reduce its tax and thus invoke S 80F of the ITA to remedy the status quo.

(iv) Arm's Length Transaction test

The arm's length transaction test is a concept that existed in the old S 103(1) and was considered in the *Hicklin's*[153] case, which held that transactions dealt at arm's length will more likely exhibit the 'normality' requirement since the parties involved will each seek to achieve the maximum gain therein.

[150] [1984] AC 474 HL

[151] Para 12(5) of the Eighth Schedule of the ITA

[152] S 80C(b)(ii) and 80E of the ITA

[153] *Hicklin v SIR*, 1980 (1) SA 481 (A), p 195

In the new GAAR most of the wording from the old S 103(1) has been retained in the ITA, save for the following phrase "*under a transaction, operation or scheme of the nature of the transaction, operation or scheme in question*" which has been deleted. It would seem that the deletion of the above phrase would serve to nullify the following *orbiter* of Trollip JA[154] *"what may be normal because of the presence of circumstances surrounding the entering into or carrying out of an agreement in one case may be abnormal in an agreement of the same nature in another case because of the absence of such circumstances."* In the *Geustyn's*[155] case, in determining whether it was abnormal not to deal at 'arm's length', Ogilvie-Thompson CJ stressed the fact that the relationships between the parties involved in the transactions have to be given due consideration and the light of these circumstances, the standards of objective normality could be relaxed.[156]

The consequence of the amendment to the 'arm's length' transaction test may be that the surrounding facts, circumstances, and relationships between parties entering a transaction not entered into at arm's length may be disregarded by the CSARS, and thus fall within the ambit of S 80A if such transaction also meets the 'sole or main purpose' requirement.

In a context of transactions involving an inter-vivos trust, whereby, a founder sells an immovable property on loan account to the trust, at a price significantly below market-related price, the following fundamental issues regarding S 80A would require due consideration: (Whilst this transaction will trigger both an application of donations tax on the gratuitous portion of the sale and also CGT in the hands of the founder)

I. Is the freezing of assets a transaction which has for the sole or main purpose of reducing or avoiding tax liability (CGT and estate duty)?

[154] *Hicklin v SIR*, 1980 (1) SA 481 (A), p 195

[155] *SIR v Geustyn, Forsyth and Joubert* 1971 (3) SA 567 (A), 33 SATC 113

[156] Silke on Income Tax, electronic version, 2010, LexisNexis, Para 19.7

II. Will the sale of an asset on loan account at a price significantly below the market price be regarded as non arm's length transaction as contended in S 80A(c)(ii) of the ITA?

III. Will the new wording of the 'arm's length transaction' test as contained in the new GAAR override the decisions in *Hicklin*[157] and *Geustyn's*?[158]

(e) Misuse and abuse of the Act

The misuse and abuse of the Act is governed by S 80A(c)(ii) of the ITA and has been drawn from S 245(4) of the Canadian ITA and it applies in both a business and non business context. The purpose of this provision is also to remedy the weaknesses of the abnormality requirement.[159] It is submitted that this provision is an alternative to the abnormality requirement, therefore if a transaction has for sole or main purpose of obtaining and tax benefit and there is also a misuse and abuse of the act, then S 80A of the ITA is applicable.[160] It is also submitted that the onus to prove that a transaction is abusive rests on the CSARS.[161]

The guidelines for interpreting this provision are found in the *Canada Trusto*[162] case, which was subsequently re-affirmed in later Canadian case of *Antle* v *The Queen*.[163] It was held that the significance of this provision is that it will not deny a tax benefit where 'it

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[157] *Hicklin v SIR*, 1980 (1) SA 481 (A)

[158] *SIR v Geustyn, Forsyth and Joubert* 1971 (3) SA 567 (A), 33 SATC 113

[159] SOUTH AFRICA. National Treasury Department, 2006, *Explanatory Memorandum on the Revenue Laws Amendment Bill 2006*, Government Printer. P 63

[160] L. Olivier et al, Juta's on Income Tax, 2010, Revision service 15, p 80A-10

[161] SOUTH AFRICA. National Treasury Department, 2011, *SARS Draft Comprehensive Guide to General Anti-Avoidance Rule*, Government Printer, p44

[162]*Canada Trustco Mortgage Company v Canada* 2005 SCC 54, Para 39:40, 62

[163] 2009 TCC 465

may reasonably be considered that the transactions were carried out in a manner consistent with the object, spirit or purpose of the provisions of the Act as interpreted textually, contextually and purposively'.

Applying the principles and the facts of the *Antle's*[164] case (trust and attribution rules) to a South African context; the taxation of trust income is governed by S 25B of the ITA and this section is subject to provisions as contained in S 7 of the ITA. The purpose of these provisions is aimed effectively at preventing parties to a trust to split or divest their income thereby reducing their tax liabilities, which is the real spirit, objective and purpose of these provisions. Therefore where there is anything contrary to S 7 of the ITA, the CSARS may invoke S 80A(c)(ii). (Notwithstanding the fact that trust income is already subject to 'specific anti-avoidance rules' CSARS may also apply GAAR by virtue of S 80I of the ITA.)

The purposive approach as mentioned by McLachlin CJ,[165] which is likely to be adopted by our courts, to positively apply this provision of the ITA, would be in circumstances where a taxpayer artificially creates a series of transactions to fall under certain provisions of the ITA to obtain a benefit. A clear example of such an arrangement would be found in the *Ladysmith* case.[166]

3.9 Chapter Conclusion

It is evident that the new GAAR has a very wide application and may bring certain transactions, which could previously not be attacked under the previous S 103(1), within

[164] *Antle* v *The Queen*, 2009 TCC 465

[165] *Canada Trustco Mortgage Company v Canada* 2005 SCC 54, Para 39:40, 62

[166] *Erf 3183/1 Ladysmith(Pty) Ltd and another v CIR*, 58 SATC 229 (A)

its ambit. SARS interpretation thereof is very aggressive, although foreign courts have disagreed with similar interpretations in their jurisdiction. Thus until a Court ruling is obtained on its interpretation and application there will be an uncertainty. In the next chapter, the practical transactions which could previously escape S 103(1) will be tested against the provisions of Part IIA of the ITA.

CHAPTER 4

The selected tax planning tools involving trusts and its application to GAAR

4.1 Introduction

This chapter introduces the selected common tax planning tools involving the interposition of a trust. These selected tax planning tools, allows the taxpayer to minimise estate duty, capital gains tax, donations tax and also in some instances income tax. These schemes will then be tested against the old and new GAAR and will be outlined in the form of scenarios/ examples.

4.2 The use of inter-vivos discretionary trust to minimise estate duty

4.2.1 Scenario A

Mr. A. aged 34 years of age, married in community of property, forms a discretionary inter-vivos trust; the trustees of the trust are himself, his wife and his accountant, as independent trustee. The income and capital beneficiaries of the trust are himself, his wife aged 30 and the two minor children. On 1 March 2010, the trust purchased a holiday house in Hermanus, for an amount of R3.5 million. The purchase was financed by an interest free loan of R1.5 million, advanced to the trust by the founder. The balance of R2 million was financed by a financial institution at the prime lending rate over a period of 10 years. Mr. A advanced an additional loan of R330,000 to the trust to settle the transfer duty, attorney's cost on transfer and bond registration costs. The trust does not have any income and therefore, Mr. A. having given personal guarantee for the bond, has to settle the monthly repayment of bond amounting to R26 500. Mr. A is also the sole shareholder of a very successful private company. The shares in the company have a market value of R10 million. On the advice of his accountant, Mr A. sold all his shares to the trust on loan account at market value and the loan is interest free. Mr and Mrs. A. further executed a joint will, whereby upon their death, they will bequeath the outstanding loan amount to the trust. It is further understood that both Mr. A and Mrs. A would take advantage of S 56(2)(b) of the ITA to donate an amount of R100,000 each to the trust every year to reduce the loan account. Following the above transactions the financial position of the trust is as follows:

ASSETS		
	Fixed Properties	3,500,000
	Plus Capitalised cost	330,000
	Total Fixed Properties	3,830,000
	Shares in Private Company	10,000,000
		13,830,000
EQUITY and LIABILITIES		
Capital		
	Trust Capital	200,000
Liabilities		
	Loan Mr. A - founder	5,815,000
	Loan Mrs A- founder's wife	5,815,000
	Loan Financial Institution	2,000,000
		13,830,000

4.2.2 The tax implications

4.2.2.1 Transfer duty

Transfer duty is payable in terms of Section 2 TDA on the value of the property acquired by a person. The rate at, at which a trust pays transfer duty, is a flat rate of 8 % of the selling price of the property which it purchases.[167]

On the other hand, a natural person pays transfer duty on a progressive rate, which is determined by the purchase price of the property acquired, as detailed hereunder:[168]

- 0 % on the first R 500,000 of the purchase price
- Plus 5 % on the next R 500, 000 of the purchase price
- Plus 8 % on the excess of the purchase price over R 1 million

Therefore there is an adverse transfer duty consequence for Mr. A in buying the property through the vehicle of a trust as the transfer duty payable by the latter amounts to R280,000 as compared to R225,000, if the property had been bought by himself or jointly with his spouse.

4.2.2.2 Securities Transfer Tax

The sale of shares from Mr. A to the family trusts is subject to STT in terms of S 2(1) of the STT Act. The STT payable by the trust on the transfer of the shares from the founder to the trust is levied at 0.25 % of the selling price of the shares, which amounts to R25,000. It is worth noting that if shares are not transferred at their market value, the difference between the value attached to the shares and the fair market value will represent a donation

[167] Rates applicable on 01 March 2010

[168] Ibid

for the purposes of Part V of the ITA and donations tax will therefore be levied accordingly.[169]

4.2.2.3 Donations Tax

The writing off of a loan in favour of a trust will fall under the definition of "donation"[170] as outlined in S 55 of the ITA. This transaction will also trigger a CGT event by virtue of Para 12(5) of the Eighth Schedule to the ITA, which will be further discussed in the next section of this chapter.

In *Welch's*[171] case, the Appellate Division held that in order for the element of donation to be present in a transaction, the disposition must be motivated by pure liberality or disinterested benevolence and not by self-interest or the expectation of a *quid pro quo* of some kind from whatever source it may come.

However, S 56(2)(b) of the ITA provides that the sum of the values of all property disposed under donations by a natural person which does not exceed R100,000 during any year of assessment, shall be exempt from donations tax.

Therefore using the exempting provision of S 56(2)(b), Mr. A and his spouse can each write off an amount of R100,000 per annum of the amount owed to them by the trust. The combined tax benefit on donations tax per annum is therefore R40,000 (20 % of R200, 000).

[169] ITC 1745, 65 SATC 181

[170] any gratuitous disposal of property including any gratuitous waiver or renunciation of a right

[171] *Welch's Estate v CIR*, [2004] 2 All SA 586 (SCA), 66 SATC 303

It will take 59 years of tax assessments for Mr A and his spouse to write off the initial loan of R5,815,000 each, advanced to the trust. The average life expectancy of a 34 year old male is 68 years and 75 years for a 30 year old female.[172] Therefore at the time of death of one of the spouses, it is highly probable that the loan account to the trust will not be extinguished using the exempting provision of S 56(2)(b) of the ITA.

In this example, the spouses had drafted a joint will whereby there will be a bequest of the outstanding loan account to the trust. Such a bequest will result in capital gains tax as a "waiver".[173] Such disposal could result in as much as a 20% effective tax in the hands of the Trust.

Bequest of the loan to the trust by the testatrix could also have a donations tax implication. This impact was brought before the court in ITC 1793.[174] It is submitted that the provisions of Part V of the ITA may have implications for the creditor, in this case the testatrix, who has waived a debt owed by a debtor, the trust. Donations tax is levied on the value of the property disposed of under a donation by a resident donor.[175]

In a later case, ITC 1835,[176] the court had to again decide whether a bequest of a loan account to an inter-vivos trust was subject to Para 12(5) of the Eighth Schedule to the ITA. In this case, the inter vivos trust was the sole heir of the residue of the estate of the testatrix and her husband who had executed a joint will, the residue of the estate being subject to usufruct in favour of the survivor of them for the duration of their life and thereafter to

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[172] Huxham, K & Haupt, P "Notes on South African Income Tax" – 2010", p. 966

[173] ITC 1793 (2005), 67 SATC 256

[174] ITC 1793 (2005), 67 SATC 256

[175] Milton Seligson SC *et al*, 2010, Business Tax & Company Law, 1(1):p 16

[176] ITC 1835 (2009) 71 SATC 105

their son for a year. The joint will also provided that the first-dying spouse would bequeath various assets, such as household possessions, to the survivor of them and the residue of the estate of the first-dying was left to the trust subject to the usufruct. The trust, at the time of the testatrix's death, was indebted to her on a loan account which fell into the residue of the estate.

In his judgment, Locock J, held that the intention of the testators was clear, namely, that the residue of the estate was bequeathed to the trust as the sole heir thereof, subject to the usufruct in favour of the surviving spouse and the son and the meaning of the word ‘residue' is well known when used in the context of a testamentary disposition. Therefore, Para 12(5) of the Eighth Schedule to the ITA could not be applied.

The fundamental difference in this case, in contrast with ITC 1793[177] was that the wording in the joint will did not classify the trust as a legatee but as the sole heir of the testatrix. It is submitted that that a legacy is a specific sum of money or asset which a testator bequeaths to a person known as a legatee. The legatee differs from an heir under a will in that an heir is the person who succeeds to the residue of the estate after all debts, costs of administering the estate and estate duty, have all been paid and all legacies distributed.[178]

It is submitted that a possible solution to the problem raised in ITC 1793,[179] is that the loan account owed by the trust could be bequeathed to another legatee, e.g. the surviving spouse or another trust. Alternatively, for the deceased to detail in the will that all debts

[177] ITC 1793 (2005), 67 SATC 256

[178] WM Van der Westhuizen *et Al* , 2009, Wills and Trusts, Butterworths, 2009:p 81

[179] ITC 1793 (2005), 67 SATC 256

due shall be discharged in full, the trust could then be left an amount of money to settle the debt that is due to it.[180]

4.2.2.4 Capital Gains Tax

4.2.2.4.1 The sale of shares in the private company to the trust

In order for a transaction to trigger a CGT event, the so called four building blocks must be present, namely, "disposal", "asset", "proceeds" and "base cost".

The shares in the private company, owned by Mr. A in the above example is an asset as contemplated in Para 1 of the Eighth Schedule to the ITA and the subsequent sale of these shares to the trust is a disposal as contemplated in Para 11(1) (a). The proceeds of R 10 million whilst on loan account is regarded as having been accrued to the seller as stipulated in Para 35. The base cost of the shares shall be determined in accordance to Part V of the Eighth Schedule to the ITA.

Since Mr A is married in community of property and the said shares is not excluded from their communal estate, in terms of Para 14 of the Eighth Schedule, the capital gain from the disposal of the shares shall be apportioned in equal proportion between Mr. A and his spouse. They will then be both entitled to an annual exclusion of R 20,000 in terms of Para 5. The taxable capital gain for both individual shall be 25 percent of the net capital gain as provided in Para 10. This amount shall then be included in their taxable income in terms of S 26 A of the ITA.

4.2.2.4.2 CGT on donations to the trust

[180] Barry Ger, 06 July 2009, leaving a loan to a family trust need not create a tax trap, SAIT (online); Huxham, K & Haupt, P "Notes on South African Income Tax – 2010", p. 728

Using the exemption provision of S 56(2)(b), Mr. A and his spouse can each write off (donate) an amount of R100,000 per annum of the amount owed to them by the trust. However, such waiver of debt could result in a capital gain for the trust.

The term 'donation' is defined in S55 of the ITA "as any gratuitous disposal of property including any gratuitous waiver or renunciation of a right" and the word 'property' as "any right in or to property movable or immovable, corporeal or incorporeal, wheresoever situated." This definition of property is wide enough to include a loan amount receivable and furthermore, it can be argued that in terms of S 58(1) of the ITA, the waiver of a debt is a disposal for no or inadequate consideration and is thus a deemed donation.

Notwithstanding the fact that the term 'donation' is not defined in S 1 of the ITA, does not mean that the legislature had the intention that should bear a different meaning for the purposes of other parts of the ITA where the term 'donation' is used.

Marais JA in his judgment in the *Welch's* case held that in order for an element of donation to be present for the purposes of S 55 of the ITA, the disposition must be motivated by pure liberality or disinterested benevolence and not by self-interest or the expectation of a quid pro quo of some kind from whatever source it may come.[181]

In the *Ovenstone*[182] case, the court had defined the terms 'donation, settlement or other disposition,' in delivering his judgment, Trollip JA defined the word donation as when

> "the donor disposes of the property gratuitously out of liberality or generosity, the donee being thereby enriched and the donor correspondingly impoverished, so much so that, if the donee gives

[181] *Welch's Estate v Commissioner, South African Revenue Service*, 2005 (4) SA 173 (SCA), 66 SATC 303, p 314

[182] *Ovenstone v SIR*, 42 SATC 55, 1980 (2) SA 721(A)

any consideration at all therefore, it is not a donation It can therefore be regarded as a unilateral contract in the sense that the donor is the only party upon whom any obligation lies".[183]

The learned judge also described the term 'settlement' in starting that:

> " In a 'settlement' the property is usually disposed of upon specific terms and conditions, set out in a deed of settlement, to or through the medium of a trustee or trustees for the benefit of some person, or for the benefit of persons in succession as in a fideicommissum. As far as the beneficiaries are concerned a settlement is also generally made gratuitously out of liberality or generosity in the sense that no consideration usually passes from them to the settlor for the benefits conferred on them. 'Settlement' is thus usually of the same genus as 'donation'. It is probably separately mentioned in the critical phrase because in form, substance, or effect it may sometimes not be regarded as a true donation".[184].

In regards to the term 'other disposition', Trollip JA, held that the *ejusdem generis* rule[185] has to be applied and therefore the term 'other disposition' should be read as 'other similar disposition' and so construed 'dispositions' as

> "means any disposal of property made wholly or to an appreciable extent gratuitously out of the liberality or generosity of the disposer. It need not flow from a unilateral contract, for that is not necessarily a common element of a 'donation' and 'settlement'. That a 'disposition' need not be wholly gratuitous and is not restricted to any particular form of disposal of property differentiates it to some extent from a 'donation' and 'settlement'".[186]

[183] *Ovenstone v SIR*, 42 SATC 55, 1980 (2) SA 721(A), Pg 73; *The Master v Thompson's Estate* 1961(2) SA 20(FC) at 24F-26C, 48F-49C, 45 .

[184] *Ovenstone v SIR*, 42 SATC 55, 1980 (2) SA 721(A), Pg 73

[185] In terms of this rule defective or ambiguous wording will be interpreted in the context of the other wording with which it is used

[186] *Ovenstone v SIR*, 42 SATC 55, 1980 (2) SA 721(A), Pg 73

In another case of *Joss v SIR*,[187] the Court held that 'other disposition' cannot include transactions made for full value of money or money's worth and that there had to be an element of liberality.[188]

Applying these above principles as had been laid by our courts, the waiver of a debt by a creditor (founder) for no commercial purpose whatsoever can be accepted to have been only motivated by liberality or generosity towards the trust, with no expectations in return (quid pro quo).

On the other hand, the definition of "asset" in Para 1 of the Eighth Schedule, is wide enough to include a loan account receivable and this has never been challenged in our courts. In terms of deeming provisions of Para 12(5)(a)(i) and (b)(i), the debtor is deemed to have acquired the waived portion of the debt at a nil base cost and deemed to have disposed of the debt to the extent of the amount waived. This will result in a net capital gain of R200,000 for the trust arising from the waiver by both Mr and Mrs A. Each donor would then have a capital loss of the amount waived (i.e. R100,000 each). It is also to be noted that not all waivers of loan will trigger the application of Para 12(5); in the case of assets sold to the trust on loan account by the founder(s), any subsequent waiver of the loan will result in the base cost of the asset being reduced by an amount equivalent to the waiver of the loan, as provided by Para 20(3)(b) of the Eighth Schedule. The waiver in turn does not trigger the application of Para 12(5) of the same schedule due to the exclusion provision of Para 12(5)(a)(aa)(B).[189]

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[187] *Joss v SIR*, 1980(1) SA 674 (T)

[188] Wills and Trust, LexisNexis, Div B, Pg 76

[189] SOUTH AFRICA, National Treasury Department, *SARS Comprehensive Guide to Capital Gains Tax, issue 3*, Government Printer, p 89:93

A trust being a non-natural person, any taxable gain included in its taxable income is 50 percent, and since a trust, other than a special trust is taxed at a fixed rate of 40 percent, the tax payable by the trust on the annual waiver of the debt shall be R40,000 per annum.

It is common practice for trusts to distribute any capital gains made by the trust to its resident natural person beneficiaries (provided the trustees are empowered to do so by the trust deed) in accordance with Para 80 of the Eighth Schedule, to minimise the tax liability. However, Para 80 is subject to Paras 68, 69, 71 and 72 (the attribution paragraphs).

The above attribution paragraphs have a mirror effect to that of S 7 of the ITA, as the capital gain on the underlying asset shall revert back to the donor of that asset if one of the Para is applicable. Its requirements for a successful application are also similar to S 7 in that there must be the element of "any donation, settlement or other disposition"[190] present.

In the example in discussion, Paras 68 and 69 of the Eighth Schedule to the ITA should be visited as the beneficiaries to the trust, in addition to the founder, include the spouse and their minor children. Therefore the attribution of a capital gain arising from a waiver of debt shall be limited by virtue of these provisions since the element of 'donation, settlement and other disposition' is present.

Para 68 of the Eighth Schedule has the same intended purpose of S 7(2) of the ITA. The purpose of this provision is thus to act as an anti-avoidance provision which aims at

[190] *Ovenstone v SIR*, 42 SATC 55, 1980 (2) SA 721(A), p 73; *The Master v Thompson's Estate* 1961(2) SA

preventing spouses[191] in splitting their capital gains, so as to be taxed at a lower marginal rate thereby reducing their combined tax liability.

In the example, in discussion, the trust will have a net capital gain of R200,000 by virtue of Para 12(5) of the Eighth Schedule to the ITA, on the annual donation by the donors. The capital gains can therefore not be attributed to one single spouse, in their capacity as beneficiary of the trust by virtue of provisions of Para 68. The capital gain would thus be taken into account in the calculation of the aggregate capital gain of the spouse making the donation and disregarded in the other spouse determination of his/her aggregate capital gain.

The net effect is that the capital gain would have to be attributed to the spouses in the proportion of their original separate donation to the trust in terms of S 56(2)(b).

Having ascertained that the element of donation is present, the capital gain attributed to the other beneficiaries of the trust (the minor children) shall be subject to Para 69 and thus be disregarded in the computation of their aggregate capital gain and shall be taken into account in the parents computation of their aggregate capital gain.

The result of these provisions will have the effect of a capital gain distributed by the trust to the two donors of R 100,000 each and also capital loss of R 100,000 as a result of the waiver of the loan.

In order to determine whether the above capital gains and losses can offset each other, Para 56 of the Eighth Schedule to the ITA should be considered. Subsection 2 of this paragraph

[191] Section 1 of the Income Tax Act No. 58 of 1962

allows the founder/doner to claim a capital loss in his hands in respect of the debt disposed of. The loss is not clogged (ring-fenced), since Para 56(2)[192] applies despite Para 39 of the Eighth Schedule of the ITA.

SARS views that if the capital loss arises from the waiver of a loan to a trust, and the capital gain in the trust is attributed back to the 'donor' under Para 80(2),[193] the creditor will not be able to claim the capital loss, since the capital gain will have been removed from the trust, and hence Para 56(2)(*a*)[194] cannot provide relief. [195]

However the above transaction has not been tested in our courts, should CSARS fail to prove that this transaction does not fall within the ambit of Para 56(2)(a),[196]the further enquiry in this case would be whether reliance can be placed on S 80C(2)(b)(iii), as an alternative to attack this scheme.

It is also worth underlining that in order for the above transaction to achieve its desired results (the reduction of the founder's loan to the trust without the consequence of Para 12(5)), the trust would need to have sufficient cash to attribute the capital gains to the beneficiaries/ donors, otherwise if such attribution is effected on loan account it will defeat the purpose of the whole scheme.

[192] Eighth Schedule of the ITA

[193] Ibid

[194] Ibid

[195] SOUTH AFRICA, National Treasury Department, *SARS Comprehensive Guide to Capital Gains Tax, issue 3*, Government Printer, p 85

[196] Eighth Schedule of the ITA

The donors can further circumvent the trap of Para 12(5), if the donation is structured in a manner in which cash is donated instead of a loan account, as the definition of “asset” in Para 1 specifically excludes any currency. The scheme in this example could be structured as follows:

The shares purchased by the trust from the donors/ founders can yield dividend income, which is exempt from taxation in terms S 10(1)(k) of the ITA. This cash can be utilised by the trust to repay the loans to the founders of the trust. The founders/donors can thereafter donate the cash of R 200,000 each to the trust. This donation will still be exempt from donations tax in terms of S 56(2)(b) of the ITA. However, such an arrangement will yield a tax benefit of R 40,000 for donations tax for the donors and an avoidance of CGT for the trust of R 40,000. The total tax benefit will thus be R 80,000. The next enquiry which will be dealt in the next section is whether such a transaction will fall within the ambit of S 80A(c)(ii) and S 80D of the ITA. It however is submitted that the fact that this arrangement is made in order to avoid CGT does not mean that it has to be treated as a sham or *in fraudem legis.*[197]

4.2.2.4.3 At death of the founders/donors

In terms of Para 40 of the Eighth Schedule, when a person dies, that person is deemed to have disposed of all his assets at market value and the deceased estate is deemed to have acquired these assets at the same value. However in terms of Para 5 of the same schedule, the deceased person will have an annual exclusion of R 200,000 instead of the normal R 20,000.

[197] Davis *et al*, Estate Planning, LexisNexis, 2010: 2A-15

Therefore by divesting their assets to a discretionary inter-vivos trust, Mr. A and his spouse may save a substantial amount on CGT, as those assets would no longer be part of their communal estate. Assuming the trust is not in a position as in ITC 1793,[198] otherwise Para 12(5) of the Eighth Schedule would be applicable to the trust.

4.2.2.5 Estate Duty

A further advantage of donating assets or cash to an inter-vivos trust is that the estate of the person will decrease in value, therefore minimising estate duty at the time of death of the person. It is also to be noted that any loan accounts due by the trust shall constitute an asset in the hands of a person at the time of death and shall therefore be subject to estate duty.

However, the loan may not increase in value, if it is interest-free, but immovable assets normally appreciate other time and value of shares in companies will depend on numerous factors. The disadvantage of an interest free loan to a trust by the donor is that it may constitute a continuous donation[199] for the purposes of the attribution rules, namely an application of S 7 of the ITA and Paras 68, 69, 71 and 72 of the Eighth Schedule to the ITA. (E.g. if a person sells assets to a trust set up for the benefit of his minor children at fair market value but refrains from charging interest on the loan, the transaction is partly onerous and partly gratuitous).

[198] ITC 1793 (2005), 67 SATC 256

[199] CIR v Berold, 24 SATC 729, 1962 (3) SA 748(A); CSARS v Woulidge, 63 SATC 483

4.2.3 Application of S 103(1) [old GAAR]

4.2.3.1 The use of inter-vivos discretionary trust to minimise estate duty

For the purpose of this section, the assumption is made that the trust has been formed before 02 November 2006 and the transactions as listed hereunder has also been processed before that date.

(A) The purchase of the holiday house by the trust, financed by an interest free loan of R1.830 million from the founder and the balance of R2 million at prime lending rate from a financial institution. The loan repayment is being settled by the founders.

Having already established that: (a) an avoidance of estate duty would constitute a 'tax benefit' under the now repealed S 103(7) of the ITA; and, (b) there would be an avoidance of CGT at the death of the founder as a secondary purpose, it would be necessary to apply the principles (as formulated by our courts) to establish whether or not the choice of using a trust for the purchase of the holiday house could fall within the ambit of the now repealed S 103(1).

The taxpayer had entered into a transaction to purchase a holiday house, which may be used for enjoyment or as an investment or both, therefore the latter has not entered into this transaction for sole or main purpose to obtain a tax benefit. The taxpayer's right in choosing the most tax effective manner to structure his affairs, has been outlined by Lord Tomlin in the *Duke of Westminster* case.[200] Following this principle, whenever there are multiple avenues to enter a transaction, the mere fact that the taxpayer has chosen the most tax advantageous one is insufficient for the Commissioner to invoke S103(1). The dual

[200] *IRC v Duke of Westminster*, 1936, 19 TC 490, p520

purpose requirement was also outlined in the *Conhage*[201] case, whereby it was held that SARS could not attack under S 103(1) of the ITA, if the main reason for entering into such transaction was business and commercially orientated. Therefore in this case the first requirement of S 103(1) of the ITA, which is the 'sole or main purpose to obtain a tax benefit' for a successful application of S 103(1), would fail.

On the issue of whether this transaction is normal or abnormal, consideration has to be given as to whether or not the said transaction has created rights or obligations which would not normally be created between persons dealing at arm's length transaction. In this example the purchase of land by the trust was at arm's length purchase. However is an interest free loan to the trust an abnormal transaction for the purpose of S 103(1) of the ITA?

In the case of *CIR v Louw*,[202] a firm of civil engineers decided to incorporate their partnership and an agreement was thus drawn to sell the partnership's assets and goodwill to the newly incorporated company on interest free loan account. Thereafter, the company had also lent considerable sum of money to its directors.

The Commissioner sought to attack the sale of assets of the partnership, including its goodwill, to the company on credit without requiring the payment of interest as abnormal with reference to the rights and obligations so created by the sale.

In delivering his judgment, Corbett JA stressed the fact that in considering whether such as transaction is normal or abnormal, the relationship between the partners and the newly

[201] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA), 1999 Taxpayer 173, 1999 (12) JTLR 337

[202] *CIR v Louw*, 1983 (3) SA 551 (A), 45 SATC 113

incorporated company cannot be viewed in isolation otherwise the nature of the transaction cannot be given the proper effect for the purpose of S 103(1) of the ITA. The newly incorporated company has as shareholders the same partners and would hence be controlled by them. It was therefore held that such as transaction was not abnormal for the purpose of S 103(1) of the ITA.

On the strength of the *Louw*[203] case, by applying its principles as laid by Corbett JA, to this scenario in issue, the donors/founders are also the beneficiaries and the trustees and the trust would hence be partly controlled by them. This special relationship as defined by Corbett JA cannot be viewed in isolation and therefore the rights and obligations so created cannot be said to be abnormal for the purpose of S 103(1) of the ITA.

(B) The sale of shares by the founders of an amount of R 10 million to the trust on interest free loan account. This sale was done on the advice of the founder's accountant to minimise their estate duty upon death.

The sale of shares to the trust by the founders/donors at market related price can be classified as a transaction dealt at arm's length. On the strength of the *Hicklin*[204] case, although this transaction has been motivated by a 'tax benefit', which also includes estate duty by virtue of S 103(7) of the ITA, it will still escape the ambit of S 103(1), since the abnormality requirement is absent. The benefit of avoiding CGT upon death of the founder will also thus escape the ambit of S 103(1) as the transaction was dealt at arm's length, based on the judgement of *Hicklin*.

[203] *CIR v Louw*, 1983 (3) SA 551 (A), 45 SATC 113

[204] *Hicklin v SIR*, 1980 (1) SA 481 (A)

(C) The use S 56(2)(b) of the ITA to donate an amount of R100,000 each to the trust every year to reduce the loan account

In the case of *CSARS v Woulidge*,[205] the taxpayer has set up two trusts for his minor children on loan account. Although the agreement of sale provided that the taxpayer could charge interest on the unpaid loan amount, he never exercised his right to charge interest. In the SCA, the CSARS sought to attack the whole transactions as a simulated transaction by suggesting that the sale actually consisted of a donation of the taxpayer's shares to the trusts. However, due to the fact that it is not permissible to raise a new point on appeal in the circumstances where the opposing party did not have a proper opportunity to deal with that point at the earlier hearing, the SCA has therefore declined to entertain that point. The SCA has nonetheless acknowledged that the Commissioner's case might have been conducted differently if the point had been raised earlier.

This argument in this case may well be an indication that CSARS may unofficially view that a sale of asset to a trust on interest free loan account and the use of S 56(2)(b) of the ITA, to extinguish the loan account over a period of years may be attacked under the common law doctrine. To succeed the CSARS will have to prove that the real intention of the donors was to donate the whole amount to the trust and the interest free loan account was a mere disguise to conceal the real nature of the transaction to the real world in order to fall within the ambit of a particular provision of the ITA to escape the liability of tax.[206]

[205] *Commissioner For South African Revenue Service v Woulidge* (24/2000) [2001] ZASCA 94; [2002] 2 All SA 199 (A), 63 SATC 483

[206] *ERF 3183/1 Ladysmith (Pty) Ltd v SIR*, 1996 (3) SA 942 (A), 58 SATC 229

Therefore, in absence of a loan agreement between the trust and the donors/founders to specify the repayment terms, security/mortgage provisions and the succession of the loan account in the event of death of the donor,[207] CSARS may have a strong case against the taxpayer on the substance versus form doctrine.

It may be suggested that a possible solution to the above problem may be obtained through the scheme as outlined in the earlier section.[208] However, SARS has warned that such a scheme can be attacked, by citing ITC 1583[209] and ITC 1690[210] where the facts were quite identical.

In ITC 1583,[211] the taxpayer had withdrawn funds from his practice in order to repay his bond which had been used to purchase his residence. He then immediately increased the bond and paid the money back into his practice. The objective of the transaction was to change the purpose of the borrowing in order to make the interest deductible. The court disregarded the transaction holding that it had merely been carried out to secure a fiscal advantage. The reasoning derived from these cases, SARS argues that if the trust does not require cash, why donate cash to the trust otherwise to secure a tax benefit?[212]

4.2.4 Application of Part IIA of the ITA (New GAAR)

(A) The purchase of the holiday house by the trust, partially financed on an interest free loan account from the founder.

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[207] *Ovenstone v SIR*, 1980 (2) SA 721 (A)

[208] Refer Chapter 4, para 4.2.1.2.4.2, above

[209] (1993) 57 SATC 58 (C)

[210] (1999) 62 SATC 497 (G)

[211] (1993) 57 SATC 58 (C)

[212] SOUTH AFRICA, National Treasury Department, *SARS Comprehensive Guide to Capital Gains Tax, issue 3*, Government Printer, p 91

(a) Sole or main purpose requirement

The issue of dual purpose of entering a particular transaction, the choice principle as outlined by Lord Tomlin in the *Duke of Westminster*[213] case was re-affirmed in South Africa in the *Conhage*[214] case. The doctrine as formulated by Lord Tomlin in the UK has been considered to be outdated with more recent cases in the same jurisdiction have departed from this doctrine as the complexity of transactions has evolved.[215] It is also an accepted fact that the taxpayer is also not compelled by GAAR to choose a transaction which attracts the most tax to satisfy the Commissioner.[216] It is clear that the financial planning in issue exhibits an arrangement[217] which results in a 'tax benefit' (including anticipated tax benefit)[218] exist, which then renders that arrangement an 'avoidance arrangement' as defined in S 80L. The next enquiry is to ascertain whether such avoidance arrangement has for its sole or main purpose to obtain a tax benefit. Since the presence of a tax benefit exists, in terms of S 80G, it will be presumed by CSARS that the avoidance arrangement was entered into solely or mainly to obtain a tax benefit. To discharge that onus a 'dual purpose' requirement may not be sufficient as was the case in the previous S 103(1), if the court interprets the new GAAR on an objective rather than subjective basis. Therefore, the taxpayer would have to provide overriding non tax reasons, which will have to be coherent to the particular facts and circumstances in issue, for entering such a transaction to escape the purpose requirement. (For example protection of assets against creditors or a family purpose).

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[213] *IRC v Duke of Westminster*, 1936, 19 TC 490, p520

[214] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA)

[215] W.T. Ramsay Ltd. v. IRC [1982] AC 300; *Inland Revenue Commissioners v. Burmah Oil Company Ltd*. [1982] STC 30; *Furniss v. Dawson* [1984] 1 All ER 530

[216] *Jabs Construction Ltd. v. The Queen*, [1999] 3 CTC 2556, Para 48; *Fredette v. The Queen*, [2001] 3 CTC 2468, Para 76; *Geransky v. The Queen*, [2001] 2 CTC 2147, Para 42 -43

[217] S 80L of the ITA; Meyerowitz v CIR, 1963 (3) SA 863 (A), 25 SATC 287, p298

[218] *CIR v King*, 1947 (2) SA 196 (A).14 SATC 184

(b) Normality requirement in a business context

The issue of whether the trust is conducting business will be a factual one,[219] if the holiday accommodation is purely for enjoyment by the founder(s) and beneficiaries, it cannot fall within the ambit of S 80A(a). On the other hand, if the trustees decide to rent the property on a continuous basis (*not once or twice*), then there will be an indication that a business is being conducted and furthermore, the definition of 'trade' in S 1 of the ITA includes the letting of any property. In that instance S 80A(a) of the ITA would apply to the 'arrangement'.

(c) *Normality requirement in a context other than business*

The principles of the *Louw*'s[220]case have been discussed in 4.2.2 above and therefore it may still stand for the purpose of S80 A (b) of the ITA as it can still be considered 'normal' for a founder to grant a family trust an interest free loan to purchase an asset. However under the new GAAR, in addition to this test, there are more tainted indicators that can be applied in this particular transaction like S 80A(c)(i) and (ii) of the ITA. It has been suggested by CSARS that these other tainted elements test has the objective of addressing the shortcomings of normality requirement in the previous S 103(1) which is very similar to S 80A(b) of the ITA.

Another test under S 80A(b), which the court can have recourse in assessing the normality of the transaction in issue, will be without doubt a 'facts and circumstances' approach[221]

[219] *Modderfontein Deep Levels Ltd v Feinstein*, 1920 TPD 288

[220] *CIR v Louw*, 1983 (3) SA 551 (A), 45 SATC 113

[221] Silke on Income Tax, 2010, LexisNexis, electronic version

which will encompass the manner in which the trusts has been managed and administered, as outlined earlier, to ascertain whether the trust is a ‘sham’ trust.

(d) Rights and obligations created at arm’s length

The meaning of arm’s length transaction under S 103(1) following the judgments in *Hicklin*[222] and *Guestyn*[223] are summarised hereunder:

- That it connotes that each party is independent of the other and, in so dealing, will strive to get the utmost possible advantage out of the transaction for himself.

- That the said transaction in issue could not be viewed in isolation but should be viewed in the context of surrounding circumstances and the relationship between the parties involved. Therefore in such circumstances the court had implied that the standard of normality could be relaxed.

Having regards to the new wording in S 80A(c)(i) of the ITA, the fundamental question that arises in this transaction in issue is whether an interest-free loan from a founder to his family trust has created a right that would not normally be created between persons dealing at arm’s length since it can now be implied that the relationship between the parties should be discarded.

The test would hence be a comparison against a hypothetical transaction that is conducted as if they were unrelated, so that there is no question of a conflict of interest. In a transaction (between non-related parties), it would be very unlikely that a lender would

[222] *Hicklin v SIR,* 1980 (1) SA 481 (A)

[223] *SIR v Geustyn, Forsyth and Joubert* 1971 (3) SA 567 (A), 33 SATC 113

lend a significant sum of money interest free and unsecured to a borrower. Hence the transaction would be likely to exhibit rights and obligations that would not normally be created between persons dealing at arm's length and thus the transaction is tainted. CSARS has however indicated that despite of the new wording, surrounding circumstances will nonetheless be considered in determining the normality of the arrangement.[224] CSARS interpretation can also not be accepted at face value as it cannot be assumed that the deleted words in S 80A have been omitted inadvertantly by the Legislature, the courts may seek to arrive at the real purpose of the new wording and apply the process as formulated in *Airworld and another*,[225] or to look at what is clearly said in the Act.[226]

(e) Misuse and abuse of the Act

This section applies to both a business and a non-business context and is considered to be an alternative or an addition to the normality test,[227] in the sense that it remedies the weaknesses of the abnormality requirement.[228] The issue whether there has been a misuse or abuse of the Act in this example, the CSARS must prove which particular provision(s) of the ITA has been misused or abused to obtain the tax benefit.

The guidelines for a successful application of 'misuse and abuse of the Act' have been formulated by McLachlin C.J in the Canadian case of *Canada Trustco*[229] are summarised hereunder:

[224] SOUTH AFRICA. National Treasury Department, 2011, *SARS Draft Comprehensive Guide to General Anti-Avoidance Rule*, Government Printer, p37

[225] *CSARS v Airworld CC and Another* [2007] SCA 147 (RSA), p59

[226] *Cape Brandy Syndicate v IRC*, 1921 1 KB 64 ,12 TC 358, p71

[227] L. Olivier et Al, 2010, Juta's on Income Tax, p 80A-10

[228] SOUTH AFRICA. National Treasury Department, 2006, *Explanatory Memorandum on the Revenue Laws Amendment Bill 2006*, Government Printer, p 63

[229] *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601, 2005 SCC 54

- First, the courts must conduct a unified textual, contextual and purposive analysis of the provisions giving rise to the tax benefit in order to determine why they were put in place and why the benefit was conferred;
- The goal is to arrive at a purposive interpretation that is harmonious with the provisions of the Act that confer the tax benefit, read in the context of the whole Act.
- Second, the court must examine the factual context of the case in order to determine whether the avoidance transaction defeated or frustrated the object, spirit or purpose of the provisions in issue;
- Whether the transactions were motivated by any economic, commercial, family or other non-tax purpose may form part of the factual context that the courts may consider in the analysis of abusive tax avoidance allegations under S 245(4).
- Abusive tax avoidance may be found where the relationships and transactions as expressed in the relevant documentation lack a proper basis relative to the object, spirit or purpose of the provisions that are purported to confer the tax benefit, or where they are wholly dissimilar to the relationships or transactions contemplated by the provisions.

In this instance it can be contended by the CSARS that the taxpayer has defeated and frustrated the object, spirit or purpose of Para 40 of the Eighth Schedule to the ITA, as the object, spirit and purpose of Para 40 is to ensure that capital gains at death are taxed when property leaves the marital unit. It is to be noted that similar interpretation was reached in the Canadian case of *Antle*[230] after applying the guidelines of McLachlin C.J.[231] The focal point will thus be on the administration of the affairs of the trust as mentioned above for a factual enquiry whether the trust is a 'sham trust'.

[230] *Antle* v *The Queen*, 2009 TCC 465

[231] *Canada Trustco Mortgage Co. v. Canada*, [2005] 2 S.C.R. 601, 2005 SCC 54

It has also been acknowledged that this provision creates an element of uncertainty and it may empower the CSARS to hit at transactions that the legislature could never have intended to attack.[232]

(B) The sale of shares by the founders of an amount of R 10 million to the trust on interest free loan account

(a) Sole or main purpose requirement

The above transaction has been entered into solely to obtain a tax benefit,[233] which is the avoidance of estate duty. The application of the 'purpose' requirement is still possible under GAAR as, despite the primary purpose was to avoid estate duty there may be an avoidance of CGT at the time of death of the seller.[234]

It is however worth underlining the fact that the issue, whether a tax benefit would be obtained by this transaction is uncertain, as the value of the shares can depend on a several economic factors. The extent of the 'tax benefit' may thus only be ascertained upon the death of the founder.

In order for a transaction or part thereof to fall within the ambit of S 80A, the transaction must also fail the normality test, the commercial substance test or the misuse and abuse requirements.

[232] Broomberg, Advocate E. SC, 2008, Misuse or abuse, *Then and now IV, Tax Planning*, 22: 31-32

[233] S 80L of the ITA

[234] Para 40 of the Eight Schedule of the ITA

(b)   Normality requirement in a business context

As discussed earlier, the issue of whether the trust is conducting business would be a factual one,[235] it is unlikely that S 80A(a) will be applicable since the trust is neither trading in shares nor conducting the business of investments.

(c)   Normality requirement in a context other than business

On the strength of the *Louw*'s[236]case, it would appear that for the purpose of S 80A(b) of the ITA as it can still be considered 'normal' for a founder to grant a family trust an interest free loan to purchase an asset.

(d)   Rights and obligations created at arm's length

Although the shares have been sold at market value, which indicates that this particular transaction has been dealt at arm's length, the sale was however concluded on loan at an interest free. By virtue of the definition of 'arrangement' in S 80L, an 'unblinkered approach' to composite transactions is possible and therefore the Commissioner may dissect part of the composite transaction and subject part of it to S 80A(c)(i) of the ITA. The issue whether the interest free loan from a founder to a trust, creates rights and obligations that would not normally be created between persons dealing at arm's length has been addressed earlier and may be seen as affirmative. It is however submitted that the interest free loan cannot be classified as abnormal as the founder may be gratuitous towards the trust and the founder may recall the loan at any time.[237]

(e) Misuse and abuse of the Act

[235] *Modderfontein Deep Levels Ltd v Feinstein*, 1920 TPD 288

[236] *CIR v Louw*, 1983 (3) SA 551 (A), 45 SATC 113

[237] Huxham, K & Haupt, P "Notes on South African Income Tax – 2010", p. 461

In order for this transaction to fall within the ambit of S 80A(c)(ii), the onus rests on the CSARS successfully prove which provisions of the ITA that has been misused and abused. It can here again be contended by the CSARS that this transaction was entered into to defeat and frustrate the object, spirit or purpose of Para 40 of the Eighth Schedule to the ITA, where Para 40 is to ensure that capital gains at death are taxed when property leaves the marital unit.[238]

(f) The avoidance of estate duty

The EDA does not contain any anti-avoidance provisions and S 80B of the ITA makes it very clear that provisions of GAAR in the ITA cannot apply to the EDA as well as they are two separate pieces of legislation.[239] However, in a business context, if a transaction falls within S 80C, the remedy still available to the CSARS rests under S 80F(a) of the ITA under the 'connected persons test'. Since the founder and the trust in this scenario are connected persons, as defined in S1 of the ITA the commissioner may disregard the trust and treat the founder (which is also a beneficiary of that trust) and the trust as one and the same person. Therefore for tax purposes it will be assumed that the trust never existed. Furthermore in such an event the CSARS will also be able to apply the Eighth Schedule upon death of the founder, thus any CGT which may have been avoided would be levied by CSARS.

(C) The use of S 56(2)(b) of the ITA to extinguish the loan advanced by the founder/donor to the trust for the purchase of assets

[238] *Antle* v *The Queen*, 2009 TCC 465

[239] Huxham, K & Haupt, P "Notes on South African Income Tax – 2010", p. 461

It is common cause that the founder uses the annual exemption of R100,000 as provided in S 56(2)(b) of the ITA to extinguish their loan account to the trust to avoid donations tax. By virtue of S 80L, the avoidance of donations tax is covered by Part IIA of the ITA.

As already discussed, in the new GAAR, whenever a tax benefit is obtained, it is presumed by S 80G of the ITA that such transaction has for its sole or main purpose to obtain a tax benefit, until proven otherwise by the taxpayer. The issue whether such transaction has as sole or main objective to obtain a tax benefit will depend on the surrounding facts and circumstances and does not automatically convert a donation to a trust as a sole or main objective to derive a tax benefit, but the onus will be on the taxpayer prove otherwise.

CSARS may contend that this transaction is a sham or disguised transaction as the real intention of the founder/donor was to donate the assets to the trust and that the sale of these assets to the trust on loan account was a disguise. This approach was explained in *Commissioner of Customs and Excise v Randles Bros & Hudson Ltd*[240] which was quoted with approval by Hefer JA in the *Ladysmith* case.[241] Consequently, it may further be advanced on behalf of the CSARS that there has been a misuse and abuse of the ITA as the taxpayer has disguised a donation in the form of a loan account to obtain the benefit of S 56(2)(b) annually.

On the other hand it may be contended on behalf of the taxpayer, on whom the onus rests, that the sale of shares and the loan advanced were genuine since CGT and STT were paid on the transaction of sale of shares. Furthermore the taxpayer has been impoverished by R100,000 following the donation. The taxpayer may have to prove that before entering this

[240] 1941 AD 369 33 SATC 48

[241] *Erf 3183/1 Ladysmith(Pty) Ltd and another v CIR*, 58 SATC 229 (A)

transaction, he/she had considered whether his financial position do permit such a donation.

In this example in issue, the prospect of the trust earning income, to repay the loan is highly probable, as the shares can yield dividend income and the purchase of the fixed property may yield rental income. In the event that there are no prospects of the trust generating income to repay that loan to the founder, it may be difficult for the latter to discharge the onus of proving that the funds advanced to the trust on loan account was not in fact a donation in real sense as there are no prospects of the loan to be ever repaid.

As outlined in paragraph 4.2.2.4.2[242] above, a donation to partially extinguish a loan (funds advanced to a trust to finance the purchase of an asset) will trigger a CGT event by virtue of Para 12(5) of the Eighth Schedule to the ITA[243] (a capital gain in the hand of the trust). In the same vein, by virtue of Para 56 (2)[244] a capital loss occurs in the hands of the donors/founders in respect of the debt disposed of. The loss is not clogged (ring-fenced) in the hands of the donors/founders, since Para 56(2)[245] applies despite Para 39 of the Eighth Schedule to the ITA.[246]

[242] P 59

[243] CGT is not triggered on a reduction of the loan (for assets sold on loan account to a trust), as it is exempted in terms of the provisions of Para 12 (5) (aa) (B) of the Eighth Schedule of the ITA. The reduction of this loan will have for effect a reduction of the base cost of the assets sold on loan to the trust by virtue of Para 20 (3) of the Eighth Schedule of the ITA.

[244] Eighth Schedule of the ITA

[245] Ibid

[246] SOUTH AFRICA, National Treasury Department, *SARS Comprehensive Guide to Capital Gains Tax, issue 3*, Government Printer, p 92

It is here assumed that the donors had successfully taken advantage of Para 56(2)(a) to offset the capital gain attributed by the trust to them in their capacity as beneficiaries against the capital loss incurred as a result of the waiver of loan in their capacity as donors/ creditors. (It is to be noted that the capital gain attributed by the trust to the beneficiaries can be only in cash and cannot be attributed on loan account otherwise there will be no reduction in loan amount.)

The further enquiry in this situation is whether CSARS can use S 80A of the ITA as an alternative to attack this scheme. This provision has a wide import and it thus be extremely onerous for the donors (who are equally trustees of that trust) to prove that the arrangement of attributing the trust capital to themselves (the donors) do not has for as sole or main purpose to obtain a tax benefit. In the event that this transaction falls under one of the tainted element, in this instance, provisions as provided by S 80A(a)(ii) read with S 80C, such a transaction would be classified as an impermissible tax avoidance arrangement. (S 80 C can only apply in a business context).

An indicative test of the lack of commercial substance which would be applicable in this instance would be found in S 80C(2)(iii) specifically targets elements that have the effect of offsetting or cancelling each other (provided that the transaction(s) in issue are in a business context). This provision originates from the British doctrine of 'fiscal nullity'. In *Furniss v Dawson,*[247] Lord Brightman formulated the following four steps or conditions must be satisfied before a series of transactions could be taxed as a composite transaction:

- The series must be pre-ordained to produce a given result;
- There must have been no purpose other than tax mitigation;

[247] [1984] AC 474 HL

- There was no practical likelihood that the events would not take place as planned; and
- The events must have taken place.

This provision is also found in S 245(4) of the Canadian ITA and has been interpreted by the Canadian courts such that these provisions will not apply in a situation where 'it may reasonably be considered that the transactions in issue were carried out in a manner consistent with the object, spirit or purpose of the provisions of the Act, as interpreted textually, contextually and purposively'.[248]

The reasons given by the Treasury for the insertion of the provisions of the indicators to be present in S 80C is that promoters often seek to defeat the application of the GAAR in several ways. For example, they may try to use a *bona fide* business transaction as an excuse or camouflage for tax driven elements with little or no commercial substance. They may try to divide aspects of an impermissible avoidance arrangement among connected persons in order to give those individual aspects a semblance of commercial substance that they lack when they are viewed as a whole. Similarly, they may introduce accommodating or tax indifferent parties to achieve the same goal or to create an appearance of arm's length dealing.[249]

Silke is of view that this provision is targeted primarily at complex schemes, typically involving complex financial derivatives, which seek to exploit perceived loopholes in the law through transactions in which one leg generates a significant tax benefit while another

[248] *Canada Trustco Mortgage Company v. Canada*, 2005 SCC 54, Para 62

[249] SOUTH AFRICA, National Treasury Department, 2006, *Tax Avoidance and S 103 of the Income tax* Act, Government Printer, p 12

effectively neutralises the first leg for non-tax purposes.[250] From that point of view it would seem that the indicative test of S 80C(2)(b)(iii) will be in affirmative in a pre-ordained transaction.

In the scenario in issue, the underlying issue is whether this transaction is pre-ordained. It has to be outlined earlier that by virtue of Paras 68, 69, 71 and 72 (the attribution paragraphs), the capital gain incurred by the trust as a result of the waiver of loan will be deemed to be those of the donor(s). Furthermore by virtue of paragraphs 39 and 56 of the Eighth Schedule to the ITA may not require the capital loss to be ring-fenced in the hands of the donors.

It is worth noting here that for tax purposes the trust, donors, and its beneficiaries, although connected persons for the purpose of S 1 of the ITA, are nevertheless separate persons for the purpose of the same Act.[251] If the donor discharges the onus of proving that the board of trustees in whom rests the power of distributing the capital gain of the trust and that he had no control over the decisions of that board of trustees and also caused no interference, then the transaction is unlikely to be preordained.

Furthermore the trustees of the trust owe fiduciary duty to the trust and must act in the best interest of that trust. In the event that the capital gain of the trust arising from the donation made by its founders is not attributed to the selected beneficiaries, the trust will face a tax liability which is an economic outflow. Thus the attribution of the capital gain made, is in the interest of the trust and not in the interest of its founders.

[250] Silke on Income Tax, electronic version, 2010, LexisNexis, 19.7

[251] S 1 of the ITA

Therefore as previously outlined in the *Badenhorst*[252] case, the management of trust affairs is always of paramount importance. (E.g. the keeping of minutes of proceedings of the board of trustees, the exclusion of trustees who may have a vested interest in certain transactions pertaining to the trust, from casting a vote on that particular matter).

(D) Bequeath the remainder of loan to the trust, at death of the founder/donor to another legatee, e.g. the surviving spouse or another trust, to avoid donations tax and Para 12(5) of the Eighth Schedule to the ITA.

As already discussed earlier, bequest of a loan to the debtor (legatee) in terms of a will shall trigger the application of Para 12(5) of the Eighth Schedule to the ITA.[253] The proposed solution to this problem is to leave the outstanding debts due to him/her by the inter vivos trust to another trust (such as a testamentary trust) or to the surviving spouse or children.[254] The requirements for a successful application of the new GAAR have already been discussed earlier and same will still apply.

In order to determine whether this transaction has for its sole or main purpose to obtain a tax benefit, the factual circumstances will be weighed against the *ipse dixit* of the executors of the estate to discharge their onus in terms of S 80G of the ITA. There is a possibility that the testatrix did not enter such a transaction solely to obtain a tax benefit. Since the loan represents monies worth, in terms of capital and/or interest repayment on that loan, the testatrix intentions may have been for the legatee to benefit from that loan after her death.

[252] *Badenhorst vs. Badenhorst*, 2006 (2) SA 255 (SCA)

[253] ITC 1793 (2005), 67 SATC 256

[254] Barry Ger, 06 July 2009, leaving a loan to a family trust need not create a tax trap, SAIT (online); Huxham, K & Haupt, P "Notes on South African Income Tax – 2010", p. 728

The factual circumstances will have to support such intention; the trust must therefore be generating enough income for the loan repayment to the legatee.

The purpose requirement is vital, if this bequest is a mere attempt by the taxpayer to extend his/her life for tax purposes in order to fall under the exempting provisions of S 56(2)(b) of the ITA and also to escape the ambit of Para 12(5) of the Eighth Schedule, then the sole or main purpose to obtain a tax benefit requirement would be met.

Assuming that the normality requirement will be met, on the strength of the judgment of Corbett JA in the *Louw's*[255] case as outlined earlier, the CSARS, may under the form versus substance doctrine argue that the whole transaction is a sham/ disguise to conceal the real nature of the transaction to the real world in order to fall within the ambit of that particular provision of the ITA to escape the liability of tax[256] and consequently the whole transaction is preordained and will also fall within the ambit of use and abuse of the Act.[257]

It is to be noted here that exemption provision of Para 12(5)(a)(aa)(B) of the Eighth Schedule to the ITA cannot be applied in this situation as it will contravene the provisions of Para 40(2) of the same Schedule.

[255] *CIR v Louw*, 1983 (3) SA 551 (A), 45 SATC 113

[256] *ERF 3183/1 Ladysmith (Pty) Ltd v SIR*, 1996 (3) SA 942 (A), 58 SATC 229

[257] S 80A(c)(ii) of the ITA

4.3 The use of testamentary trust to avoid/minimise estate duty

The amendement[258] to Section 4A of the EDA, provides that when a person was the spouse at the time of death of one or more previously deceased persons, the dutiable amount of the estate of that person must be determined by the deduction from the net value of his or her estate of an amount equal to R3,5 million:

- Multiplied by two; and
- Reduced by the amount deducted under section 4A from the net value of the estate of any one of the previously deceased persons.[259]

<u>Example</u>

Mr and Mrs. B were married in community of property, at the time of death of Mr. B; their joint estate had a market value of R 8 million. Mrs B had bequeathed all her assets to her husband. After 10 years, Mr. B also passed away.

In terms of the EDA, the estate duty position of Mrs B at the date of death is as follows:

Property in terms of S3 (2)	4,000,000
Less deductions - S 4 q	4,000,000
Net Value of Estate	-
Dutiable amount of the Estate	-

In terms of the EDA, the estate duty position at the date of death of Mr. B is as follows:

[258] Section 4A of the EDA was amended for persons dying on or after 01 January 2010.

[259] Davis *et al*, Estate Planning, LexisNexis, 2010: 9-4(2); D Escott-Watson "*the portability of the estate duty abatment between spouses"* Insurance and Tax journal March 2010

Property in terms of S3 (2)	12,000,000
Less abatement - S4A (1)	7,000,000
Dutiable amount of the Estate	5,000,000
Estate Duty	1,000,000

Prior this amendment to S 4A of the EDA, some taxpayers were using a testamentary trust as a vehicle where it was possible to artificially carry-over the abatement of S 4A(1) of the EDA. This was being done, where the first dying spouse would bequeath R3.5m worth of property[260] or deemed[261] property to a trust and the remainder to the surviving spouse.

The estate duty of the dying spouse would be minimised to nil because of the S 4(q) deduction and the abatement of R3.5m on properties kept in his/her estate and bequeathed to the family trust.

The effect on the surviving spouse is that only the value properties bequeathed to him/her by the deceased spouse, at his/her date of death, plus any additions thereof would be included in the gross value of property. He /she may also deduct from that amount any allowable deductions as provided by S 4 of the EDA and will also be entitled to an abatement of 3.5 million.

[260] S 3 (2) of the EDA, valued in terms of S 5 of the EDA

[261] S 3 (3) and (5) of the EDA, valued in terms of S 5 of the EDA

4.3.1 Application of S 103(1) [old GAAR]

As already mentioned the avoidance of estate duty would amount to a 'tax benefit' within its meaning in S 103(7) of the ITA. Although, the main purpose of the transaction is to obtain a tax benefit (estate duty), there are no taxes covered within the ITA (income tax, CGT or donations tax) that has been avoided. Therefore in terms of the provisions of S 103(1) and taking into consideration of the definition of 'tax' in S 1, the Commissioner would not be empowered to re-determine the liability for any tax, duty or levy on income and the amount thereof as if the transaction, operation or scheme had not been entered into or carried out.

4.3.2 Application of Part IIA of the ITA (New GAAR)

It is submitted that provisions of GAAR in the ITA cannot apply to any "other acts" (including the EDA) administered by CSARS, because these Acts are separate pieces of legislation. This is made clear by virtue of the remedy provisions contained in S 80B of the ITA, which states that "the Commissioner may determine the tax consequences under this Act of any impermissible avoidance arrangement".[262]

Therefore if an arrangement is entered into that has solely for objective and purpose to avoid estate duty, VAT, transfer duty amongst others, the tax benefit obtained could not be prevented under S 80A as the CSARS would not have a remedy in S 80B to recover the tax so avoided.

In spite of the above, applying Part IIA of the ITA to an arrangement involving trusts, in an event where transactions, which falls in a business context, involves elements of lack of

[262] Huxham, K & Haupt, P "Notes on South African Income Tax – 2010", p. 461

commercial substance as defined in S 80C of the ITA, CSARS may still have recourse to S 80F concerning connected persons[263] to remedy the avoidance of taxes.

It is worth noting that there are no general anti-avoidance provisions in the EDA as there are in the ITA and VAT Acts. General anti-avoidance provisions in the EDA were proposed in the 2008 Draft Revenue Laws Amendment Bill but were ultimately rejected.[264] It is therefore possible that the CSARS has acknowledged that there are shortcomings in Part IIA to prevent and remedy the avoidance of estate duty.

4.4 The use of a discretionary inter-vivos trust to divest income from the founder/donor

Trusts are taxed according the provisions of S 25B of the ITA; however S 25B is made subject to S 7 of the ITA, which effectively means that in the tax computation of the trust, the provisions of this section shall be applied first and effectively overrides the provision of S 25B(1). This will then determine whether the income will be taxable in the donor's, the beneficiaries' or the trust's hands. This is also known as the attribution rules of trust income and this section (S 7) acts as a specific anti- avoidance provision.

Most sub-sections of S 7 of the ITA require the element of 'donation, settlement or other disposition' be present and in that event, the income so attributed shall be deemed those of the donor to the trust. However, S 7(1) does not require that element to be present, thus income so attributed to a resident beneficiary who is a child of the donor and has attained the age of majority shall be tax in the beneficiaries hand. It is here assumed that there are

[263] S 1 of the ITA

[264] Davis *et al*, Estate Planning, LexisNexis, 2010: 2-44(5)

no conditions set by the trustees or the trust deed[265] to the effect that the beneficiary shall not receive the income until the happening of an event, otherwise S 7(5) of the ITA shall prevail. The question whether the discretionary power of the trustees to distribute trust income constitutes an ‘event’ for the application of subsection 5 still remains a moot point.[266]

Example

Mr. C, aged 55, had founded a discretionary inter-vivos family trust in 1992. The beneficiaries to the trust are the founder and his two children. The trust bought an investment flat in that year, which was partly financed by a loan from the founder and a loan from a financial institution. The rental income derived by the trust was used to repay the bond and financed other expenses, such as levies, insurance and maintenance cost. At the current date, the loan contracted from the financial institution has already been repaid. The loan from the founder has also been extinguished by using the annual exempting provisions of S 56(2) of the ITA.

The two children of the founder are aged 20 and 21, being the other beneficiaries to the trust and are both universities students and do not earn any income. The trustees attribute the net monthly income of R 15,000 equally between the two children of the founder and this income finances their studies and their maintenance.

4.4.1 The income tax implication

Trust

[265] *Estate Dempers v SIR*, 39 SATC 95

[266] Huxham, K & Haupt, P “Notes on South African Income Tax – 2010”, p. 746

Since the net income of the trust has been vested to the beneficiaries, S 7(1) of the ITA applies and therefore the R180,000 is not taxed in the trust. It is submitted that the exercise of a discretionary power in respect of income distribution by trustees is an event as contemplated in S7(5) of the ITA. Therefore the income of a discretionary trust which arise from a donation, settlement or disposition will always be taxed in the 'donors' hand in terms of S 7(5) of the ITA unless it is distributed to the beneficiaries.[267]

The Founder (year of assessment ending 28 Feb 2011)

Mr. C, is employed and his yearly taxable income is R 300,000, therefore, for his tax payable is R 58,890. If the net income of the trust was vested to Mr. C in terms of S 7(5) of the ITA, he would have had a taxable income of R 480,000 and thus a tax liability of R 123,110.

The other beneficiaries (year of assessment ending 28 Feb 2011)

The other two beneficiaries being unemployed and having been vested a yearly income of R 90,000 each, their tax liabilities thereon is R 5,940 each.

Conclusion

As illustrated in this example, Mr. C has successfully divested income to his two major children using a trust as a vehicle and has also minimised considerably the tax liability by entering into a transaction with the other beneficiaries. Furthermore, if the rental income had accrued to him without the use of a trust, he would not have been able to deduct the expenses of maintenance of his two children by virtue of S 23(a) of the ITA. The issue whether the exercise of discretion to distribute income by the trustees in a discretionary

[267] Huxham, K & Haupt, P "Notes on South African Income Tax – 2010", p. 741

trust would constitute an event for the purpose of S 7(5) of the ITA is not clear and will remain so until a decision is made by the courts.[268]

4.4.2 Application of S 103 (1) [old GAAR]

(a) Sole or main purpose to avoid tax

On the interpretation of 'sole or main purpose to avoid the liability of taxation', Beyers JA[269] concurred with the findings of the special court, where Watermeyer J said the following:

> "As a result of this series of transactions the income which the appellant would have received for his work and labour was transferred to his children, and the effect of the transactions was to avoid liability by the appellant for tax on that income. . . The word "scheme" is a wide term and I think that there can be little doubt that it is sufficiently wide to cover a series of transactions such as those mentioned above".

The preceding phrase of S 103 (1) which is 'transaction, operations or scheme', is wide enough to encompass the vesting of the trust income to the beneficiaries to minimise tax liability as the trust is taxed at a higher rate than individual taxpayers. However if the trustees is merely giving the effect of the objective of the trust deed such a transaction would not have as sole or main purpose to avoid tax.

Furthermore, the vesting of trust income may also have a dual purpose, i.e. the minimisation of tax and also for the finance of the founder's children's education needs. Since the exercise of a discretionary power in respect of income distribution by trustees is an event as contemplated in S 7(5) of the ITA, the income of the trust which arise from a

[268] Huxham, K & Haupt, P "Notes on South African Income Tax – 2010", p. 746

[269] Meyorowitz v CIR, 1963 (3) SA 863 (A), 25 SATC 287, p 299 - 300

donation, settlement or disposition will always be taxed in the ‘donors’ hand in terms of S 7(5) of the ITA unless it is distributed to the beneficiaries.[270] Thus the trustees is left with the option of taxation being levied on the entire trust net income in the founder’s hands or vest same to the other beneficiaries to minimise its tax liability as the trust may not be taxed in this particular instance.

The trustees’ right in choosing the most tax effective manner to achieve the desired goals, has been outlined by Lord Tomlin in the *Duke of Westminster* case[271] and was also accepted in *Conhage.*[272]

(b) Abnormality and arm’s length transaction

This kind of scheme has not been viewed on a positive light from the courts. In the case of *Meyerowitz v CIR*[273], in delivering his judgment, Beyers JA addressed the issue of abnormality in a similar scenario by referring to the judgement of Watermeyer CJ in *CIR v King*[274] and Schreiner JA at 216 where the following statement was expressed:

> “Now normally and naturally the owner of an income-producing asset receives the income and the labourer receives the reward of his labour. Any departure from this order of things, if done with the object of prejudicing the fiscus, is the subject of legitimate objection by the Commissioner, which is met by the machinery of the section. In such cases, and in my view in such cases alone, it can be said that the Commissioner is seeking to tax the taxpayer on what is “in reality his income”, to use the expression employed by the Chief Justice. It is in reality his income because it should have accrued to him, and it can only be said that it should have accrued to him if it was the fruit of his capital or of his labour or both”.

[270] Huxham, K & Haupt, P “Notes on South African Income Tax – 2010”, p. 741

[271] *IRC v Duke of Westminster*, 1936, 19 TC 490, p520

[272] *CIR v Conhage (Pty) Ltd (formerly Tycon (Pty) Ltd)*, 1999 (4) SA 1149 (SCA), 1999 Taxpayer 173, 1999 (12) JTLR 337

[273] *Meyorowitz v CIR*, 1963 (3) SA 863 (A), 25 SATC 287, p 299

[274] *CIR v King*, 1947 (2) SA 196 (A), p 210-212

Therefore a taxpayer who took advantage of S 7(1) of the ITA through the use of a trust, to divest himself of the fruits of his investments, to his children may be seen as abnormal. However, in the example in issue, the fruits of the investment do not belong to the founder/donor as the purchase of the property was financed partly by a financial institution; a transaction which was dealt at arm's length. The gratuitous element present in this example is the interest free loan and subsequent donation of capital to the trust and such transactions are not viewed as abnormal.[275]

Furthermore the vesting of the trust income vests on the discretion of the board of trustees. If the founder/donor does not have sufficient power to influence the board of trustees and the vesting of the trust income is in the objective of the trust, such a transaction may also not be viewed as abnormal or as sole or main purpose to avoid the liability of tax. In the event that trustees are merely used as rubber stamps, the courts have sanctioned this practice. In the *Badenhorst vs. Badenhorst*[276] case, where Combrinck AJA stated that:

> "*de iure* control of a trust is in the hands of the trustees, but very often the founder in business or family trusts appoints close relatives or friends who are either supine or do the bidding of their appointer. *De facto* the founder controls the trust. To determine whether a party has such control it is necessary to first have regard to the terms of the trust deed, and secondly to consider the evidence of how the affairs of the trust were conducted during the marriage".

Therefore the sound management of the trust plays a vital role as we have witnessed in the *Badenhorst vs. Badenhorst*[277] and the *Land and Agricultural Bank of South Africa v Parker*[278] case.

[275] *CIR v Louw*, 1983 (3) SA551 (A), 45 SATC 113

[276] 2006 (2) SA 255 (SCA), Para 9

[277] 2006 (2) SA 255 (SCA)

[278] 2005 (2) SA 77(SCA)

(c) Substance v/s form doctrine

The court may establish whether the substance of the transaction differs from its form, in other words the court needs to apply the "*simulated transaction doctrine*". The application of this doctrine has been outlined in Para 3.3. One of the indications for its successful application would be the trail of the trust funds that has been attributed. In the event that trust fund which has been attributed to the beneficiaries (other than the founder/donor) has not actually been paid or expended for the purposes as stipulated in the trust deed, then there would be no substance in the transaction and can this be viewed as a sham.

4.4.3 Application of Part IIA of the ITA (New GAAR)

Is there a presence of an avoidance arrangement**?**

The term ‘arrangement’ defined in S 80L of the ITA and the wordings ‘transaction, operation or scheme’ as contained in its definition, has been interpreted by the courts to be of such wide import that it is difficult to conceive how any question of tax benefit could arise without there being a transaction operation or scheme. In the *Meyerowitz*[279] case, the court held that the term ‘scheme’ had a wide scope and could be applied if, viewed as a whole, the steps taken are so connected one with the other that they led to an avoidance or reduction of tax.

On the other hand, the term ‘avoidance arrangement’[280] means any arrangement that results in a tax benefit. The tax benefit obtained in the attribution of trust income to circumvent S 7(5) of the ITA has been demonstrated above and is thus present.

(a) Sole or main purpose to obtain a tax benefit

In applying the purpose test under the old GAAR, the courts have preferred to apply the subjective test as opposed to an objective test.[281] However in the new GAAR by virtue of S 80G of the ITA, it could result that the courts will deviate and apply an objective test whereby the focal point is on the ‘effect ‘rather than relying on the intention of the progenitor of the scheme and testing same to the particular facts of the case.[282]

[279] *Meyerowitz v CIR* 1963 (3) SA 863 (A), 25 SATC 287

[280] S 80L of the ITA

[281] *SIR v Gallagher* 1978 (2) SA 463 (A), 40 SATC 39

[282] Louw, I.D.P, 2007, The General Anti-Avoidance Rule: A comprehensive discourse on this statute, Cape Town, UCT, Postgraduate diploma in law dissertation, p25

Although in this scenario, the entire scheme of the creation of a trust was for a legitimate family purpose, S 80G may empower the CSARS to apply GAAR to only part or step therein and in this case the attribution of trust income to beneficiaries other than the founder. However, in the *Canada Trustco* case, in deciding on the purpose test in S 245(3) of the Canadian Income Tax Act, McLachlin C.J applied a restrictive approach and expressed the following:

> *"The expression "non-tax purpose" has a broader scope than the expression "business purpose". For example, transactions that may reasonably be considered to have been undertaken or arranged primarily for family or investment purposes would be immune from the GAAR under s. 245(3). Section 245(3) does not purport to protect only transactions that have a real business purpose".*[283]

The choice principle has also been endorsed by the Australian courts in their interpretation of GAAR, in the case of *Cridland v FCT*.[284] The taxpayer, a university student, invested in a unit trust, the court accepting that his sole purpose was to obtain the benefit of averaging his income according to the averaging provisions. Even though he deliberately created a favourable tax consequence, he was not caught by the anti-avoidance provision as the Act statutorily provided for this. Indeed, the validity of the transaction was not affected merely because the attendant tax consequences were advantageous to the taxpayer, even though he entered into the transaction deliberately with a view to gaining that advantage.[285]

In the interpretation of S 80G, Olivier is of view of that it is presumed that an avoidance arrangement was carried into for the sole or main purpose to obtain a tax benefit and this

[283] *Canada Trustco Mortgage Company v Canada* 2005 SCC 54, Para 33

[284] *Cridland v FCT* (1977), 16 ALR 355 at 360

[285] Silke on Income Tax, 2010, LexisNexis, electronic version, Chapter 19.6

shifts the onus on to the taxpayer to prove otherwise.[286] It is further submitted that if the taxpayer discharge that onus and the purpose is not tax avoidance S 80A of the ITA cannot be applied.

Therefore an argument from the taxpayer that the attribution of trust income by the trustees to his children was effected for the sole or main purpose to finance their studies and prove that such monies was actually expended for that purpose, S 80A may not apply as the taxpayer is under no obligation to pay more tax than is required, he may choose a method to achieve his objective which is tax effective and that does not convert the transaction into one for obtaining a tax benefit.[287]

(b) The abnormality requirement and arm's length transaction test

The abnormality requirement in the new GAAR is governed by S 80A(a)(i) and (b) of the ITA and the arm's length transaction test is governed by S 80A(c)(i). The arguments thereof have already been discussed above under the old GAAR and will still stand.

(c) The lack of commercial substance test

The commercial substance test is a pre-requirement in a business context for the application of S 80A (S 80A(ii)), and this is defined in S 80C of the ITA. For the purpose of this example, S 80C(2)(a) is mostly applicable and the test of its successful application has been discussed above and will also still stand in this instance. The purpose of these provisions according to the National Treasury was to remedy the weaknesses of the abnormality requirement,[288] but in any event these provisions were still in existence under

[286] Olivier, L. et al, Juta's on Income Tax, 2010, Revision service 15, p 80G-1

[287] ITC 1625 59 SATC 383

[288] SOUTH AFRICA. National Treasury Department, 2006, *Explanatory Memorandum on the Revenue Laws Amendment Bill 2006*, Government Printer. P 63

the judicial doctrines of legal form versus substance. Failure to pass the commercial substance test as defined in S 80C, the CSARS will be entitled to enforce S 80F of the ITA and treat all parties to this transaction as one and same person and therefore discard the attribution rules of S 7 of the ITA.

(d) The misuse and abuse of the Act

The misuse and abuse of the Act is governed by S 80A(c)(ii) of the ITA. The purpose of this provision is also to remedy the weaknesses of abnormality requirement.[289] It is submitted that this provision is an alternative to the abnormality requirement, therefore if a transaction has for sole or main purpose of obtaining and tax benefit and there is also a misuse and abuse of the act, then S 80A of the ITA is applicable.[290] The guidelines for interpreting this provision are found in the *Canada Trusto* [291] case.

The taxation of trust income is governed by S 25B of the ITA and this section is subject to provisions as contained in S 7 of the ITA. The purpose of these provisions is aim effectively at preventing parties to a trust to split or divest their income thereby reducing their tax liabilities, which are the real spirit, objective and purpose of these provisions. Notwithstanding that trust income is already subject to specific anti-avoidance rules CSARS may also apply GAAR by virtue of S 80I of the ITA. However, if the board of trustees as already mentioned earlier are merely executing the purpose of the trust and the tax benefit obtained is merely incidental, the ITA could not have been frustrated, the act can only be frustrated if the series of transaction is pre-ordained. In that event, this

[289] SOUTH AFRICA. National Treasury Department, 2006, *Explanatory Memorandum on the Revenue Laws Amendment Bill 2006*, Government Printer. P 63

[290] L. Olivier et al, Juta's on Income Tax, 2010, Revision service 15, p 80A-10

[291]Canada Trustco Mortgage Company v Canada 2005 SCC 54, Para 39:40, 62

transaction may change its characteristics and may then become tainted as it can meet the 'sole or main purpose' requirement.

4.5 End of chapter conclusion

It is evident that the new GAAR may have far reaching consequence on any arrangements that has for effect and results in a tax benefit. In a context of trusts, it has become more important that the purpose of the trust is clearly defined and should be other than tax benefits. The new GAAR also brings a certain amount of uncertainty in the tax system and without the guidance from our courts to interpret it in a South African context the depth of its application can only be subjective.

CHAPTER 5

Conclusion and Recommendations

5.1 Concluding remarks

Prior formation of a trust, its progenitor must always perform a feasibly study to weigh the benefits of such vehicle and the corresponding costs and responsibilities towards its formation and also have to ascertain whether a trust will meet the required aims and objectives as laid down by the founder.

In determining whether GAAR would apply to particular transactions in the trust, the courts may follow the steps as already laid down in cases involving trusts in non tax related environments, as has outlined hereunder, where the focus was on the administration of the trust and the control[292] of the founders/donors over trust. The behaviour of the trustees and the administration of the trust will then give a clear indication as whether the trust is a sham trust and thus all the related transactions entered by the trust are preordained and preconceived to obtain tax benefits and the courts then may order that the trust be pierced/or disregarded.

[292] In delivering his judgment in the *Badenhorst v. Badenhorst* case, 2006 (2) SA 255 (SCA), Para 9, Combrinck AJA stated the following:

> *"de iure control of a trust is in the hands of the trustees, but very often the founder in business or family trusts appoints close relatives or friends who are either supine or do the bidding of their appointer. De facto the founder controls the trust. To determine whether a party has such control it is necessary to first have regard to the terms of the trust deed, and secondly to consider the evidence of how the affairs of the trust were conducted during the marriage".*

5.2 Recommendations

Hereunder are some recommendations which trustees may follow to help the trust discharge its onus in terms of S 82 and S 80G of the ITA once the CSARS has invoked Part IIA of the ITA on transactions involving a trust.

(i) The trustee owes fiduciary duty to the trust and his private affairs should be completely separated to the trust, thus have to avoid conflict of interest at all times;[293]

(ii) The trust need to appoint independent trustees;[294]

(iii) The trust need to appoint accounting officers to prepare financial statements and help the public officer of the trust to submit the tax returns to SARS;

(iv) The trust need to formally keep minutes of the meetings of proceedings of the board of trustees to evidence that all decisions taken on behalf of the trust were made collectively;

(v) In the event that any trustees may have an interest, the trustee should be excluded from the quorum to avoid conflict of interest. However the remaining trustees should ensure that they have the power and quorum in terms of the trust deed to pass a resolution affecting the trust;

(vi) Every transaction affecting the trust should have a clear purpose (even if the main purpose is a tax benefit) and must fall within the objects of the trust.

[293] *Land and Agricultural Bank of South Africa v Parker*, 2005 2 SA 77 (SCA), Para 36

[294] Trust Property Control Act 57 of 1988 s 7(2)

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